

# PANAMA CANAL TREATY RAMIFICATIONS

## Part 1

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### HEARINGS

BEFORE THE

### SUBCOMMITTEE ON THE PANAMA CANAL

OF THE

### COMMITTEE ON

### MERCHANT MARINE AND FISHERIES

### HOUSE OF REPRESENTATIVES

NINETY-FIFTH CONGRESS

FIRST SESSION

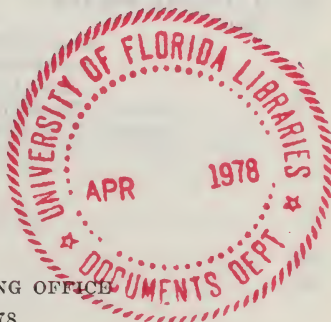
ON

THE ECONOMIC AND FINANCIAL RAMIFICATIONS OF THE  
PROPOSED PANAMA CANAL TREATIES AND THE ROLE THE  
SUBCOMMITTEE WOULD PLAY IN IMPLEMENTING THE  
TREATIES

NOVEMBER 30, DECEMBER 1, 1977

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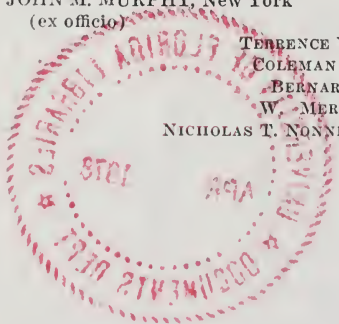
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## ECONOMIC AND FINANCIAL RAMIFICATIONS OF THE PROPOSED PANAMA CANAL TREATIES

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WEDNESDAY, NOVEMBER 30, 1977

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON PANAMA CANAL,  
COMMITTEE ON MERCHANT MARINE AND FISHERIES,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 1302, Longworth House Office Building, Hon. Ralph H. Metcalfe (chairman), presiding.

Mr. MELCALFE. The subcommittee will come to order.

On September 7, President Carter signed the proposed Panama Canal Treaties of 1977. Since then, the treaties and their accompanying documents have been formally sent to the Senate of the United States.

Today and tomorrow, the Panama Canal Subcommittee will examine the economic ramifications of the treaties. The economic and financial ramifications of the Panama Canal Treaty are of great importance to the Subcommittee on the Panama Canal. The subcommittee is especially concerned because under the rules of the House, the Merchant Marine and Fisheries Committee, in general, and this subcommittee in particular, has jurisdiction over the "Panama Canal and the maintenance and operation of the Panama Canal \* \* \*."

These hearings have been called because it is this subcommittee which will have to review and, if necessary, modify the implementing legislation, if the treaties are ratified. The subcommittee will be especially concerned with the new entity which will replace the present Panama Canal Company and also with the financial management of the Panama Canal.

We had hoped to have the enabling legislation before us prior to these hearings. The State Department legal adviser stated in his testimony before a House committee on September 8, 1977, that "We do hope to submit the proposed implementing legislation within a period of weeks \* \* \*." Obviously, we cannot wait indefinitely before we discharge our responsibilities.

The treaties and their accompanying agreements tell us a good deal about the future finances of the Panama Canal. Hopefully, today and tomorrow we will have the kind of substantive exchange which will prompt the best possible legislation, if the treaties are ratified.

We have announced three basic hearing objectives, which are (1) examination of the financial prerogatives and responsibilities of the projected Panama Canal Commission under the proposed treaties; (2) analysis of the change in the rate of tolls needed to finance the Commission, and the relationship of that change to canal traffic; and (3) procedural and constitutional questions that relate to implementing Panama Canal Commission obligations.

It would not be appropriate for us to discuss these financial questions today were it not for the fact that the proposed Panama Canal Commission, which will operate the canal to the year 2000, is to be a U.S. Government agency.

This agency is one of the most important, but underrated elements of the treaty package. I commend the negotiations for their attention to this element in the treaty talks.

All of the witnesses have been furnished with rather detailed questions. The subcommittee has asked the witnesses to direct their attention to those questions. We hope their prepared testimony and their answers in response to questions of the subcommittee will be responsive and detailed.

In order to make the record of these hearings as clear as possible, I ask unanimous consent that the questions to the individual witnesses appear at the appropriate interval in the hearing record, unless the questions are included in the witness's statement.

Hearing no objection, it is so ordered.

I am informed that the Honorable John M. Slack of West Virginia, who is chairman of the Subcommittee on State, Justice, Commerce and the Judiciary of the House Appropriations Committee, has asked permission to sit in on these hearings.

Would you please come up, Congressman Slack.

I would ask unanimous consent that the subcommittee be as generous as is the chairman of the Subcommittee on State, Justice, Commerce. I ask that we reciprocate his generosity because in February of this year he invited the members of the Subcommittee on the Panama Canal to accompany him and his committee to Panama.

We would like to extend to him the same kind of courtesy so that he will be able to sit in and ask questions and make comments because his subcommittee has a vital interest in the treaty issue itself.

We are delighted to have you, Chairman Slack. Unless there are any objections, we will accord you that privilege of participating.

Mr. SLACK. Thank you. I would appreciate it very much.

Mr. METCALFE. Come up and sit with us.

Incidentally, all members of the Merchant Marine Committee have been invited to participate in these hearings.

Mr. SLACK. Thank you.

Mr. METCALFE. I have a few other remarks. Because of the nature of the hearings, and the importance of the matter before us, the subcommittee hopes to issue a report with respect to the issues raised in these hearings.

Finally, I wish to indicate that the chair intends to conduct these hearing proceedings in accordance with rule III(b) of the committee rules and comparable House rules which provide that on the first round of questioning members will be granted 5 minutes each. There is a tremendous amount of material to be covered in the hearings, and

many witnesses to be questioned, so I think it is imperative we adhere to this procedure.

Before I introduce our first witnesses, I would like to give our members an opportunity to make any opening statements they desire.

Does anyone seek recognition?

Mr. SNYDER. Mr. Chairman?

Mr. METCALFE. The gentleman from Kentucky, Mr. Snyder.

Mr. SNYDER. Mr. Chairman, I am looking forward to these hearings as a primary source of information for the American people as to exactly what the proposed Panama treaties will cost them.

I suspect the cost is far higher than the administration spokesmen would have us believe. I welcome the opportunity to put questions to them and other knowledgeable expert witnesses. It is my conviction that the taxpayers will end up footing another very unwelcome bill costing millions should these Panama treaties be ratified.

The last time this committee met the treaty negotiators on August 17, the treaties had not been published, and I found those gentlemen quite unwilling to answer some very simple, elementary questions concerning the security of the United States under the proposed agreements.

Perhaps they will be more forthcoming at this time in regard to those few questions.

My position is well known as urging the defeat of the proposed treaties.

As far as the security of the United States is concerned, our possession of the Panama Canal in peace and war is vital. I see no sense in our global conflict with the Soviet Union in throwing in our hand—our top cards—and I think the American people agree with me.

Many Americans, including Members of Congress, suspect the banking interests may be behind the canal giveaway. I have no knowledge as to whether or not they are, but there have been numerous allegations in the press. For example, an article in *Bankers Magazine* for spring 1977, flatly says of the banks, and I quote:

They want the taxpayers of the creditor countries to pay the bad debts with the money passing—in theory only—through the hands of the debtor governments on its way to repay bank loans.

An article in the *London Daily Telegraph*, March 3, 1977, states:

Apart from political considerations the Carter Administration is also believed to be under pressure from American banking interests to hand the canal over to Panama.

If there is substance to these allegations, the American people should know of it. If there is none, the allegations should be laid to rest.

This past August, Senator Frank Church issued a staff report titled "International Debt, the Banks, and U.S. Foreign Policy."

I'd like to ask a number of questions based on some things that have appeared in this report and in the press.

Let me set the background in a few excerpts from the Church report.

The Senator sets the problem in his introduction as follows:

But what we have been dealing with since the oil price increase of 1973 are not temporary deficits but a structural defect in the world economy in which enormous financial surpluses are concentrated in the hands of a very few coun-



tries which cannot spend them for goods and services. They are thus deposited in the "strong" industrial countries. The "weak" oil deficit countries then borrow from the major financial institutions in the strong countries. And there is no end in sight to this cycle of a few permanent financial surplus oil producer countries and burgeoning international indebtedness by weaker oil importing countries.

The central theme of the Church report, written by Ms. Karen Lissakers of the subcommittee staff, is that the world's major international banks have become more and more overextended in lending to the debtor oil importing nations and their financial positions are becoming more and more precarious.

Mention is made of the Basle, Switzerland, agreement in July 1974 of the Board of Governors of the Bank for International Settlements, the "central bankers' central bank."

The United States, though not a member of the BIS, subscribed to the Basle accord at the annual International Monetary Fund meeting in Washington in October 1974.

The report states that under the agreement, "Consortium banks which have multinational bank participation will be bailed out on a pro-rata basis by member parent banks, again backed by their own central banks."

Note the words, "will be bailed out."

Key to the background I am setting is this statement in the report:

It is worth noting that the central banks asked nothing from the private banks in return for their guarantee, at least officially . . . Commercial banks can continue to compete on the euromarket at margins which do not insure profitability, to take on deposits and external credits without adequate capital reserves and to roll over hundred million dollar loans to underdeveloped countries who have little or no hope of ever being able to pay them back, without interference from any governmental authority. And if such practices lead to disaster, the governments are pledged to come to the rescue.

Discussing the nature of the use underdeveloped countries make of these loans just to maintain a given level of domestic consumption, the report states:

Doubts are therefore raised about the ability of some countries to ever repay their foreign loans, or, in the long run, even to continue to meet interest payments on those loans.

Toward the end of the report Lissakers cites the Citibank loan to Zaire which had fallen behind in its repayments. Zaire agreed to pay up back interest only if Citibank committed itself to a new \$250 million loan.

Lissakers sums up the incident with this amazing sentence:

*The Zaire Government is thus holding the money it owes the banks hostage for a \$250 million ransom.*

She goes on:

The Zaire case raises some interesting questions about just who has the greatest leverage at this stage of international debt buildup—the creditor banks, or the debtor countries? Was Citibank's willingness to undertake the task of raising another large loan to Zaire a prudent and sensible response to restore the credit-worthiness of a borrower, or a desperate attempt to avoid as long as possible having to write off a substantial loss on an international loan, and perhaps thereby set a precedent for other debtor countries to follow suit?

Wrapping up the overall international activity, Lissakers asks "whether this process of deficits, recycling, borrowing, and debt re-



scheduling can go on indefinitely," and answers it in a way that is, I believe, quite worrisome:

The viability of the whole international financial system is premised on the assumption that all the players stay in the game; that the banks continue lending, and the borrowers keep repaying the interest, so that although the principal may be refinanced or "rolled over" for individual borrowers, the money continues to circulate. The biggest threat to the system lies in the possibility that one of the passengers on this merry-go-round will decide to get off—that one of the large debtors finally decides to repudiate its debts, or one of the lenders says "no more" and calls in the chits. Other lenders then follow in order to protect their interests and a domino effect sets in. As the crisis created by the collapse of Herstatt and Franklin National several years ago illustrates, even the disappearance of a relatively minor player can set the multinational banking system teetering.

Finally, in conclusion, Lissakers asks the \$64 question:

The question arises of how prudent the banks have been in their lending . . . Has the profitability of this activity blinded them to the underlying risks? Or has the banks willingness to lend to foreign countries for balance of payments purposes been premised on the unstated assumption that in the event of a real debt repayment crisis, the governments of the wealthy industrial countries will have to come to the rescue because they cannot afford to see either the debtor countries or their own large banking institutions go under?

Mr. Chairman, Panama is a debtor nation with almost 40 percent of its annual budget now dedicated just to debt service.

American and foreign banks have been coming to the rescue.

I hope we can find out in these hearings if the American people are being set up to bail out the banks, and if, perhaps, the canal giveaway just might play a role in this bailout.

My questions all relate to my central concern here: Is the Panama Canal vulnerable—to international bankers?

I repeat, I don't know if the many allegations that such is the case have substance. If they do, the people should know it. If such allegations are without merit, they should be laid to rest.

I am a firm believer in the free enterprise system and have no desire to worsen the banking climate with untoward fear, but news stories on which my questions will be based reflect growing concern in banking and government circles.

The witnesses may have to obtain some answers from other agencies and submit them in writing, and I hope this can be done expeditiously. Of course, any proprietary information I may request should be submitted without identifying the individual bank involved.

Mr. METCALFE. Thank you, Mr. Snyder.

Are there any other members who wish to make a statement?

[No response.]

Mr. METCALFE. We will proceed. Our first witnesses are our distinguished Ambassadors who negotiated the Panama Treaty, Ambassador Ellsworth Bunker and Ambassador and Adviser Sol Linowitz. They are accompanied by their colleagues on the negotiating team. These are the first witnesses in a long series of distinguished persons who will be testifying today and tomorrow.

Ambassadors, this is the first time that you have appeared before the subcommittee since the treaties have been signed. Several other committees have been able to hear your testimony. We await the enlightened statements that you may be able to give us.

**STATEMENT OF HON. ELLSWORTH BUNKER AND HON. SOL M. LINOWITZ, TREATY NEGOTIATORS, ACCOMPANIED BY RICHARD COOPER, UNDER SECRETARY FOR ECONOMIC AFFAIRS**

Ambassador BUNKER. Thank you.

Mr. Chairman, members of the Panama Canal Subcommittee of the House Committee on Merchant Marine and Fisheries, Ambassador Linowitz and I are here today at the subcommittee's invitation to discuss some of the economic aspects of the proposed Panama Canal Treaties.

We are accompanied also by Mr. Richard Cooper, Under Secretary for Economic Affairs.

The Ambassador and I will each have an opening statement.

These statements are intended to complement the lengthier written response which the Department of State has prepared to the questionnaire received from the subcommittee in advance of the hearings.

This written response accompanies the texts of our statements.

Let me turn first to the rationale for the economic and financial arrangements that will flow from the new canal agreements.

These arrangements fall into three broad categories.

First, there are the payments to Panama established by treaty.

Second, there are the changes in the anticipated expenses and revenues of the canal enterprise as a result of modification of its functions and responsibilities under the new treaties.

Third, there is an economic cooperation program—which Ambassador Linowitz will discuss—comprising loans, credits, and guarantees to be offered to Panama outside the framework of the treaties.

The basic premise of the canal negotiations, from their inception 13 years ago under President Johnson through three successive administrations of both parties, has been that the U.S. interest in an open, secure, and efficiently operated canal can best be advanced through cooperation rather than confrontation with Panama.

In negotiating these treaties, we have sought to establish the basis for an effective partnership between the United States and Panama in the canal enterprise.

An essential element for the success of that partnership is that Panama have a significant and direct economic stake in the efficient operation of the canal.

This concept was part of the guidelines under which the negotiations were conducted.

In the February 1974 joint statement, the United States and Panama agreed that "The Republic of Panama shall have a just and equitable share of the benefits derived from the operation of the canal in its territory."

The joint statement continued: "It is recognized that the geographic position of its territory constitutes the principal resource of the Republic of Panama."

This concept was part of the guidelines under which the negotiations receives support not only from treaty proponents but also from many opponents.

Many of these opponents acknowledge that Panama's direct benefits from the rights it granted to the United States under the 1903 treaty and subsequent amendments should be increased.



Two other principles set forth in the February 1974 joint statement are fundamental to establishing a cooperative relationship with Panama and are also important because of their economic and financial implications.

One of these principles is that Panama will exercise jurisdiction over the area of the Canal Zone.

The other is that the United States will operate the canal for a fixed period on the basis of a grant from Panama of specific operational rights.

Consonant with these two principles, the Panama Canal Commission, which will operate the canal after the new treaties go into effect, will have more limited functions and responsibilities than its predecessor agencies, the Panama Canal Company and the Canal Zone Government.

Most governmental functions will in general be eliminated, and public service and commercial-type activities will be greatly reduced.

Specific guidelines for activities to be undertaken by the Commission are contained in the annex to the Panama Canal Treaty.

They will bring important changes in the costs and revenues of the canal enterprise.

Another important provision of the new Panama Canal Treaty is that the Panama Canal Commission, which is to operate the canal through December 31, 1999, will be U.S. Government agency.

This means that major elements of the financial structure of the Commission are not specified in the treaty but are left for determination by the United States.

We expect that many of these matters will be addressed in the legislation implementing the treaties.

Having pointed out these general considerations which affect the financial and economic impact of the new canal agreements, I now want to address some of the specific arrangements established in the treaties.

Under article XIII of the Panama Canal Treaty, Panama is to receive annually certain payment from canal operating revenues.

These are an amount equal to 30 cents per Panama Canal net ton, or its equivalency, for each vessel transiting the canal. The rate for this payment will be adjusted biennially to reflect changes in the U.S. Wholesale Price Index for total manufactured goods; a fixed annuity of \$10 million; an amount of up to \$10 million to be paid from any surplus of canal operating revenues over Panama Canal Commission expenditures.

In working out these provisions we had two basic considerations in mind.

Consistent with our objective of building a solid United States-Panamanian partnership, we thought it highly desirable that Panama have a strong economic stake in the continued efficient operation of the canal.

We also sought to insure that the canal would continue to be self-sufficient, thereby avoiding recourse to the U.S. taxpayer to fund payments to Panama.

The Panamanian negotiators, for their part, originally proposed higher payments than we projected the canal enterprise could sustain.

However, the provisions of article XIII, as finally negotiated, met our objectives.

All payments are to come from canal revenues, and have been set at levels which the canal enterprise should be able to generate.

The payments to Panama are linked to the operation of the canal.

The most important source of revenue to Panama will be the payment of 30 cents per canal ton; and the yield from this is directly dependent on canal traffic.

This payment constitutes Panama's principal financial stake in the success of the canal enterprise.

The provision for adjustment of Panama's 30-cent-per-Panama Canal-ton share of the tolls according to the U.S. Wholesale Price Index for total manufactured goods insures that Panama's financial interest in the canal will not be vitiated by inflation.

The contingent payment of up to \$10 million per year to Panama will be possible only if the canal is able to operate efficiently enough to produce a surplus.

The rationale behind this payment is that Panama should have an incentive to cooperate with the Commission to keep operating costs low and operating efficiency high.

I should also add a comment about the fixed annual payment of \$10 million.

This payment was agreed upon in response to Panama's view that it should receive a substantial lump sum payment in exchange for our rights under the treaty.

Panama's original proposal was for a lump sum payment of over \$1 billion, which was later reduced to \$460 million.

While we were unwilling to agree to a lump sum payment, we did agree to a fixed annual payment that would come, like the variable annuity, from canal revenues.

This payment from canal revenues was unlinked from the number of actual transits to ameliorate the otherwise major upheaval to the Panamanian economy that would result if a landslide or other temporary closure of the canal limited transits for a substantial period.

A further payment to Panama is established in article III, which provides that the Panama Canal Commission will reimburse Panama for specified public services which Panama will furnish to the canal enterprise.

These services are currently provided by the Canal Zone Government at an estimated yearly cost of \$18 million.

The treaty establishes that the amount of reimbursement will be \$10 million annually during the first 3 years.

This lower payment to Panama takes into account Panama's lower wage scale, together with the fact that the area serviced will be smaller than at present, since the Panama Canal Commission's operating areas and the housing areas for U.S. citizens will comprise only a portion of the territory presently included in the Canal Zone.

Because of the difficulty of estimating in advance the cost to Panama of providing these services, article III specifies that after the first 3 years the amount of reimbursement may be adjusted to reflect inflation and other relevant factors, such as changes in the actual cost of the services provided.



We believe that the canal enterprise should be capable of generating revenue to meet these payments to Panama under the treaty.

Our judgment is based on estimates of future traffic and possible toll revenues.

Data available to us during the negotiations indicated that a toll increase in the neighborhood of 30 percent would likely produce sufficient revenues to support projected operating expenses, including all payments to Panama except the contingent \$10 million payment from surplus.

This brings me to the final subject which I would like to discuss—the implications of the new agreements for the financial structure of the canal enterprise.

This is a matter on which precise comment is not possible in all cases, since, as I noted earlier, many key elements of the Commission's procedures and organization are not specified in the treaty but are left for determination by the Congress in the implementing legislation and by the Commission itself.

However, I can make certain observations, which I hope will be useful.

The Commission will have certain costs that are fixed by the Panama Canal Treaty. These include the payment per canal ton—initially 30 cents—to be paid to Panama, the \$10 million fixed payment for Panama, and the public service payment.

Both the costs and the revenues of the Commission will, of course, be affected by the distribution under the treaty of the functions and responsibilities currently performed by the Panama Canal Company and the Canal Zone Government.

The canal enterprise no longer will have the responsibility to provide certain services; on the other hand, certain of its current revenue-producing activities will be transferred to Panama.

Just as the United States retains considerable discretion to control Panama Canal Commission expenditures, it will also have authority to establish a toll structure that is within the general guidelines set forth in the Neutrality Treaty, which provides that tolls must be just, reasonable, and equitable.

We expect that the toll formula will be one of the topics addressed in the proposals for implementing legislation that the administration will be submitting to the Congress.

Finally, concerning financial flexibility for the canal enterprise in case of emergency, we are considering recommending that the implementing legislation continue for the Panama Canal Commission the same authority to borrow from the Treasury and to seek appropriations on a reimbursable basis now held by the Panama Canal Company.

Mr. Chairman, that concludes my statement.

Ambassador Linowitz will now address some of the other topics which you have raised.

Mr. METCALFE. Thank you, Ambassador Bunker.

Now, we will hear from Ambassador Linowitz.

Mr. Ambassador.

Ambassador LINOWITZ. Thank you.

Mr. Chairman, members of the subcommittee, of all the questions involved in the negotiations with Panama for a new canal agreement,

none had a higher priority than that of assuring permanent and nondiscriminatory access to the canal for the ships of all nations. That is the principal topic which I will address in my statement this morning. I will also comment on the United States-Panamanian economic cooperation program which was developed simultaneously with the treaty negotiations.

With regard to canal access, our objective was to make certain that the canal would be open and available to all world shipping without discrimination during the period of U.S. management of the canal and indefinitely thereafter. This was achieved through negotiation of a separate neutrality treaty, which is to remain in effect permanently.

The Neutrality Treaty establishes certain principles which constitute the regime of neutrality that will govern the operation of the canal permanently. The fundamental concept for the operation of the canal is contained in article II of the treaty. This provides that the canal will remain secure and open to peaceful transit by vessels of all nations without discrimination concerning the conditions, or charges of transit, or for any reason. This basic assurance of nondiscriminatory access to the canal is the same as that set forth in the 1901 Hay-Pauncefote Treaty between the United States and Great Britain, which governs access to the canal today.

Article III of the treaty sets forth that portion of the regime of neutrality which provides the general guidelines for canal operation. They include provisions that the canal be operated efficiently, that tolls and rules of navigation be reasonable and equitable, that services necessary for transit be available, and that military vessels may transit at all times without inspection and irrespective of their armament or means of propulsion.

Another particularly important element of the regime of neutrality appears in article V of the treaty. This article prohibits, after the year 2000, foreign operation of the canal, as well as the garrisoning of foreign troops and the maintenance of foreign military installations in Panama. This provision, which was strongly supported by both the United States and Panama, provides clear notice that neither the United States nor Panama would tolerate any attempt to establish foreign domination in Panama after that country assumes responsibility for canal operation.

Panama and the United States have also agreed in article VI that as part of the regime of neutrality, United States and Panamanian military vessels may transit the canal expeditiously when they consider it necessary.

And this is important.

Furthermore, Panama has undertaken, through article I of the treaty, to apply this and all other elements of the regime of neutrality to any other interoceanic canal that may ever be built in Panama. Thus, the United States is assured that any canal in Panama always will be operated in an efficient manner in accordance with the rules of nondiscriminatory access provided in this treaty, will not be operated or defended by a third country, and will be available for expeditious passage by U.S. military vessels at all times.

The United States and Panama are individually responsible for maintaining this regime of neutrality. Their responsibility, set forth in article IV, provides that each country has the right to act against



any aggression or threat directed against the canal or against the peaceful transit of vessels through the canal. The two countries have confirmed this understanding of the meaning of article IV in identical statements issued October 14 in Washington and October 18 in Panama.

To sum up, the principles embodied in the proposed Neutrality Treaty provide assurance to the United States of continued nondiscriminatory access at reasonable tolls to an efficiently operated canal for all our vessels permanently.

Now let me turn to the economic cooperation program, which developed out of the canal negotiations but, as I said, it is separate and independent from the Panama Canal Treaty. As Ambassador Bunker has noted, the Panamanian negotiators originally proposed that Panama receive a much larger annuity under the treaty than we ultimately agreed upon. They also proposed that the United States make a large initial lump-sum payment which far exceeded the most optimistic estimates of what canal revenues could generate. In this connection, the Panamanian negotiators stressed the importance to Panama of being able to undertake rapid social and economic development with wide distribution of benefits to its people during the first few years of the implementation of the new treaty relationship.

As Ambassador Bunker has emphasized, our position prevailed that Panama's share of the economic benefits from the canal should be supportable from canal revenues alone; that is, that payments to Panama should reflect the canal's economic value as measured by our projections of its revenue-generating capacity.

At the same time, however, we recognized that there was merit, from the standpoint of the future U.S. interest in the canal, to add further stability to the Panamanian economy by heeding Panama's development needs. This Panamanian development will help create the conditions of stability that will enhance the prospects for an open, safe, efficient, and accessible canal permanently.

We therefore arranged for the Panamanian representatives to meet with representatives of the Departments of State, Treasury, the Agency for International Development, and the Export-Import Bank to consider Panama's development needs. In doing so, we made it clear to the Panamanian negotiators that any arrangements to assist with Panama's development were to be separate from the canal agreements themselves and were in no way to be tied to the rights and obligations of the United States and Panama under the Panama Canal Treaty and the Neutrality Treaty.

Out of these discussions emerged a program of projected loans, credits, and guarantees which was set forth in a diplomatic note from Secretary of State Vance to the Panamanian Ambassador. This note constitutes an offer of assistance to be brought into effect through a subsequent exchange of notes. The elements of this program are: Up to \$75 million in AID housing guarantees over a 5-year period; up to \$200 million in Export-Import Bank loans, loan guarantees, or insurance over a 5-year period subject to approval by the Bank; a guarantee by the Overseas Private Investment Corporation of \$20 million in U.S. private capital to the Panamanian National Finance Corp.—COFINA—for use in productive projects in the private sector; and

issuance of repayment guarantees under our foreign military sales program not to exceed \$50 million over a 10-year period.

Under Secretary of State Cooper is here and will be able to answer any questions you have on this aspect.

It is important to point out certain features of this cooperation program. First, it is in the form of an agreement to agree. Our undertakings would become effective upon an exchange of notes to that effect. Once these undertakings do come into effect, they are subject to availability of funds and to compliance with applicable legal requirements established for each of the existing programs. The economic cooperation program was designed to utilize financial assistance programs that are suitable to Panama's stage of development and directed at meeting Panama's present economic needs for low-income housing and a growing private sector. Such assistance would be channeled through existing programs that are established tools for furthering U.S. interests abroad. And all elements fit within existing statutory authorization.

We believe this is a sound and useful program. It is separate from the Panama Canal Treaty because the assistance to be provided does not relate to our rights and obligations under that treaty. But we expect this assistance to make a positive contribution to the successful implementation of the new United States-Panamanian partnership in the canal enterprise which will grow out of the new treaties.

That, Mr. Chairman, concludes my opening statement.

Now, Ambassador Bunker and I will be pleased to answer your questions.

[The following questions were posed to the witnesses and their responses received prior to the hearing:]

#### DEPARTMENT OF STATE RESPONSES FOR THE RECORD TO QUESTIONS FROM THE SUBCOMMITTEE

*Question 1.* Specify the rationale used in connection with all economic, financial and related provisions of the accords and related agreements, including, for example, the payment to Panama for public services provided in the area of the present Canal Zone and the inflationary adjustment provided for the \$.30 compensation of Panama Canal tonnage.

*Answer:* The general criterion used in determining the basis for the economic and financial terms of the Panama Treaty and related agreements is contained in the so-called Kissinger-Tack Joint Statement of Principles signed on February 7, 1974.

The fifth of these principles reads as follows: "The Republic of Panama shall have a just and equitable share of the benefits derived from the operation of the canal in its territory. It is recognized that the geographic position of its territory constitutes the principal resource of the Republic of Panama."

The payment to Panama for providing public services in the Canal area will be made to compensate it for services, which we formerly provided but which will be provided by Panama after the Treaty enters into force. Since the new Canal Commission will not pay taxes to Panama, it was believed that Panama should be compensated through a payment from Canal revenues for the services it will undertake.

The justification for the inflationary adjustment for the 30¢ royalty paid on Panama Canal tonnage is contained in the answer to another question.

*Question 1a.* What was the rationale for payments to Panama out of Canal operating revenues rather than provision of an annuity without definition of source?

*Answer:* Specification of annuity payments without definition of a source would have made the annuity payment an obligation of the United States, payable out of the general funds of the U.S. Treasury. We wanted to ensure that: Treaty pay-



ments would reflect a fair return to Panama for the operation of the Canal in its territory during the period of our administration of the Canal; treaty payments would not constitute—to the maximum extent that we could anticipate and plan—a burden on the American taxpayer; Panama would have a financial stake in the continued efficient operation of the Canal.

*Question 1b.* What was the rationale for economic arrangements outside the written texts of the agreements?

Answer: Panama's initial economic demands were not compatible with our view that any payment to Panama under the new treaty would have to be financed from Canal revenues. However, we perceived that because of the Canal we have now and will continue to have a special relationship with Panama. We felt, therefore, that it was in our own interest to enhance Panama's economic stability and security by promoting sound economic development there. Such assistance would also benefit U.S. investors and businessmen by giving them an opportunity to participate in Panama's growth.

Because the treaties are intended to deal only with matters relating directly to the operation and defense of the Canal, the proposed economic cooperation programs are separate from and outside the Treaties. The rights and obligations of the United States under the Canal treaties are therefore not linked to the implementation of the economic cooperation program. The program is to be carried out within the framework of existing statutory programs. The proposed arrangements consist entirely of loans, credits and guarantees. There are no grants.

*Question 1c.* What was the rationale used in determining the activities to be transferred to Panama and those to be retained by the Canal Commission?

Answer: The basic premise used in deciding which of the activities currently performed by the Panama Canal Company or the Canal Zone Government would not be performed by the new Panama Canal Commission was that the new Commission should not engage in purely governmental or commercial function not directly related to the operation of the Canal.

This principle is established in paragraph 2 of the Annex to the Panama Canal Treaty, which also recognizes that the Commission may, however, undertake any activities necessary for efficient Canal operation and maintenance. Under this general principle, the two illustrative lists set forth in the Annex show the types of functions which the Commission may not perform as well as the types of functions it may. Concerning governmental services, the reassumption of jurisdiction by Panama over the Canal Zone by reason of the abrogation of the 1903 Treaty meant that the governmental functions currently performed by the Canal Zone Government in general would no longer be performed by the United States. Thus, for example, the civilian police force, the court system, customs services, and immigration services operated by the United States will cease to function either upon entry into force of the Treaty or at the end of the 30 month transition period.

Some of the governmental services, like educational services and medical care, will not be provided by the Commission, but will continue to be available for U.S. citizen employees through use of U.S. military school and hospital facilities in Panama.

Concerning commercial activities, it was decided that in general Panama should derive the benefit of such service performed in its territory. Thus, commercial cargo handling and bunkering will be undertaken by Panama under conditions designed to assure the continued efficient conduct of these activities. However, practical consideration dictated that functions like the provisions of commercial utilities services continue to be provided by the Commission, since it must retain the facilities to provide such services for its own internal operations. Housing for U.S. citizen employees is another example of a commercial type service which the Commission will continue to provide because of the close correlation between adequate and reasonable housing in the vicinity of the Canal and employee morale and efficient Canal operation.

*Question 2.* Article III, paragraph 3, of the Panama Canal Treaty provides that the United States shall carry out its responsibilities in reference to operation of the Canal by means of a U.S. government agency "which shall be constituted by and in conformity with the laws of the United States of America." To which laws does this section make reference?

Answer: One of our major negotiating objectives was to retain Congressional authority over the operation of the Canal during the life of the Panama Canal Treaty. Thus, we sought and obtained treaty provisions which established that the Canal will be operated by a United States Government agency constituted

ly and in conformity with the laws of the United States. Accordingly, the Congress will have the authority to establish the Panama Canal Commission by appropriate legislation. Such legislation would address, *inter alia*, the organizational structure of the Commission, its relationship to the rest of the United States Government, and its powers and duties. Moreover, Congress would remain free to amend such legislation concerning the Commission throughout the Treaty's duration.

It should be noted that Article III of the Panama Canal Treaty also provides that "the United States of America shall, *in accordance with the terms of this Treaty and the provisions of the United States law*, carry out its responsibilities by means of [the Panama Canal Commission]." Thus, the Congress will retain ongoing legislative authority over all matters concerning the management, operation and maintenance of the Canal for which the United States is responsible under the Treaty.

This authority would include legislating the means for establishing toll rates, the conduct of relations with our employees, budget and accounting practices, etc. The Commission and all its officers and employees will be fully subject to such legislation.

**Question 3.** In your view, how should the obligations now incumbent upon the Panama Canal Company compared with those obligations that ought to be shouldered by the Commission? Specifically, what do you recommend with respect to the statutory obligations: (a) to make annual payment on the net direct investment of the U.S. in the Panama Canal Company; (b) to reimburse the Treasury for appropriations for the costs of the Canal Zone Government; (c) to pay the portion of the annuity now provided by Canal toll revenues; (d) to pay to the Treasury as dividends amounts of funds in excess of operating and capital requirements (2 CZC 70); (e) to pay back to the Treasury any funds borrowed at a determined interest rate (2 CZC 71); and (f) to pay back to the Treasury all appropriations to cover losses.

**Answer:** The question of carrying over, modifying or terminating the various statutory obligations applicable to the existing Panama Canal Company is, of course, a matter to be ultimately decided by U.S. legislation. The Administration's preliminary views, however, keyed to the specific statutory provisions as mentioned in the question are as follows:

a. The Administration would recommend repeal of the provision requiring an annual payment on the direct investment of the U.S. in the Panama Canal Company. This provision creates a burden on toll revenues that is essentially in the nature of a dividend or profit to the United States Government on its operation of the Canal. The Administration supports the continuation of the principle that the Canal operation should be self-sufficient. The United States interest in the Canal is not in making a profit, but in the economic and military value of its availability to the United States.

b. Inasmuch as the Canal Zone Government will cease to operate in the Republic of Panama upon entry into force of the Treaty, this statutory provision must clearly be amended. We do, however, consider that the Canal Commission should continue to reimburse other agencies for services rendered. For example, the operation of U.S. schools and hospitals in Panama will be taken over by the U.S. military, and we believe the Canal Commission should be directed to reimburse those agencies on a pro-rata basis. Similarly, we have agreed in the Treaty that the Canal Commission will reimburse the Government of Panama for certain other public services now performed by the Canal Zone Government which it will take over upon entry into force of the Treaty.

c. Inasmuch as the Treaty establishes that all annuity payments to Panama are to be paid out of Canal revenues, the statutory provision requiring reimbursement to the Treasury for a portion of the annuity now paid out of appropriated funds would be rendered meaningless and hence should be repealed.

d. The Treaty would clearly permit payment to the Treasury of surplus funds. If, after payment of all its operating and capital expenditures, including the payments to Panama under paragraphs 4(a) and 4(b) of Article XIII of the Panama Canal Treaty, the Commission has excess funds, we would be obligated to pay Panama such excess up to the amount of \$10 million. To the extent the surplus exceeded that \$10 million, the funds may be disposed of in such manner as the United States deems appropriate, and the Administration would support legislation to return such surpluses to the Treasury.



e. and f. Consistent with the concept of a self-sustaining operation, the Administration would support continuation of the existing statutory requirements to repay borrowed funds or funds appropriated to cover losses.

*Question 4.* What rate of inflation was contemplated in estimating the effect on cost of the provision of Article XIII, paragraph 4(a), for adjustment of the payment of \$.30 per Panama Canal ton "to reflect changes in the United States wholesale price index for total manufactured goods"?

Answer: We cannot accurately forecast long-term inflationary trends and no particular rate was contemplated as the basis for Article XIII(4)(a) of the Treaty.

The purpose of indexation of the 30-cent annuity is to maintain Panama's financial stake in the Canal's operation at an equitable level in real terms. To ignore the effects of price changes could mean that Panama's financial return from, and hence interest in, the efficiency of the Canal operation would diminish substantially during the Treaty period. The Wholesale Price Index for manufactured goods was used because it is a modest, yet reasonable measure of price changes, on the basis of past performance.

*Question 5.* Do the negotiations provide any indication as to what was meant by the term "or its equivalency" as used in paragraphs 4(a) of Article XIII of the Treaty providing for the payment to Panama of \$.30 per Panama Canal net ton "or its equivalency, for each vessel transiting the Canal \* \* \* for which tolls are charged"?

Answer: Under the new treaty, the United States will operate and manage the Canal. This includes responsibility for the setting of tolls and the control of Canal traffic upon which tolls would be assessed.

The words "or its equivalency" are designed to maintain an equivalent return to Panama in the event the United States exercised its prerogative to change the unit of measurement for Panama Canal traffic.

*Question 6a.* How should the annual amount of up to \$10 million per year for payment to Panama under Article XIII(c) of the Treaty be treated on the books of the agency operating the canal?

Answer: The Article XIII(c) payment will not be treated as an operating expenditure of the Canal operation. It will be a charge only against any surplus of operating revenues over expenditures as these will be defined by legislative or administrative action.

*Question 6b.* How should the annual amount of up to \$10 million per year for payment to Panama under Article XIII(4)(c) of the Treaty be treated in the determination of toll rates?

Answer: The Article XIII(4)(c) payments are a contingent obligation. There is no requirement under the treaty that would make the Article XIII(4)(c) payment an element for determination of toll rates. Therefore, this payment depends on the efficient operation of the canal.

The United States will set canal toll rates in accordance with the procedures to be established by the implementing legislation on this subject.

*Question 7.* Do the negotiations provide any indication or do you have any suggestion as to how determination will be made of the extent to which revenues of the Canal exceed expenditures for purposes of the \$10 million payment to Panama provided for by Article XIII, paragraph 4(c) of the treaty? Are "expenditures" as used in that provision exclusive of obligations?

Answer: The establishment of an accounting and financial system for the new Canal Commission will be within the discretion of the Commission under the authority provided it by the legislation implementing the treaty.

We anticipate that expenditures would include obligations of the Panama Canal Commission. In addition to the costs of Canal operation, such as those for lock operations, traffic control, housing, etc., Canal operating expenditures would include the 30-cent per Panama Canal ton annuity payment and the fixed \$10 million annual payment. However, they would *not* include the payment of up to \$10 million under Article XIII (4)(c), which is a contingent obligation under the Treaty.

*Question 8a.* Under Article XIII, paragraph 4(c), what responsibility does the U.S. have to the Republic of Panama in any given year if "the operating revenues in any year do not produce a surplus sufficient to cover the payment"?

Answer: According to Article XIII (4)(c), any unpaid balance in any single year would be paid "from operating surpluses in future years in a manner to be mutually agreed".

*Question 8b.* Is this financial responsibility cumulative?

Answer: Yes, but only to the extent that there are operating surpluses in future years and subject to the terms of mutual agreement with Panama.

*Question 8c.* What will be the financial responsibilities of the U.S. to the Republic of Panama (under the proposed agreement) in the year 1999 if, in fact, there has been no surplus in the preceding years?

Answer: There will be no obligation by either the Canal Commission or the U.S. Government to pay Panama any unpaid cumulative obligation after December 31, 1999.

The payments under Article XIII (4) (c) are a contingent obligation to be met from surplus Canal revenues of the Panama Canal Commission. After December 31, 1999, the Commission will no longer receive Canal operating revenues (which will then be received by Panama). We will accordingly make no further payments from Canal revenues.

*Question 9a.* How was the figure of \$10 million arrived at for the payment for public services to be provided by Panama?

Answer: The current estimated costs to the Canal Zone Government for the services for which Panama is to be compensated are about \$18 million per year.

It was finally agreed that \$10 million was a reasonable initial figure to be paid to Panama because: Panama should be able to do the same job at lower cost since it has a lower wage scale than that used in the Canal Zone; and the services to be compensated for under the Treaty are limited to Canal operating and housing areas and thus cover less than half of the area of the present Canal Zone, for which the Canal Zone Government currently provides such services.

*Question 9b.* What rate was used for estimating the effect of provisions of the treaty for adjustment of the \$10 million annual payment provided by Article III, paragraph 5, in reimbursement for certain "public services" "because of inflation and other relevant factors affecting the cost of such services"?

Answer: The provision for reimbursement for public services was considered a reasonable compensation in the short-term, i.e., the first three years of the Treaty period. The Treaty formula was, however, intended to compensate Panama for actual cost. Therefore, it was logical to build in a provision for flexibility to reflect future costs to Panama in the years ahead.

It is not possible to estimate rates of increase or decrease for future costs. The Canal enterprise has not received public services from Panama in the past. Once Panama begins to provide Canal operating and housing areas with public services, it may be that actual costs will run below \$10 million. On the other hand, long-term inflation may eventually raise costs above that level.

*Question 10.* What part of the Canal agreement would allow for the financial flexibility needed for Canal operations during times of emergency and great fluctuations in traffic?

Answer: According to Article III, the United States has the right to manage, operate and maintain the Canal. Inherent in this right is the power to legislate regarding the financial structure of the new Canal operation. Therefore, the financial aspects of Canal operations will be molded by implementing legislation and by the actions of the proposed Panama Canal Commission.

To cover the possibility of emergency or unusual traffic conditions, the implementing legislation would presumably grant the Commission the authority for prudent management, for example, through continuation of the borrowing authority now possessed by the Panama Canal Company.

*Question 11.* If for any reason the Canal Commission were unable to meet its operating expenses and make payments to Panama, where would the Commission obtain funds needed to meet its obligations?

Answer: In the interest of prudent management, we would recommend that the Treaty's implementing legislation provide the Commission with sufficient borrowing authority to meet such contingencies as is the case with the Panama Canal Company under present law.

*Question 12.* What terms are contemplated for the "loans, guaranties and credits" to be provided to Panama under the agreement supplementary to the Treaty? Will these be related to the development of the Canal?

Answer: Any project implemented under the proposed economic cooperation program will be subject to the normal criteria and procedures of the agency involved.

These programs—AID housing guarantees, OPIC investment guarantees and Eximbank loans, loan guarantees and insurance—do not offer concessional terms, but rather, involve interest rates and fees which approximate those of the market.



The development of the Canal itself will be at the discretion of the United States during the Treaty period. However, the current Panamanian development investment program contemplates several projects that would enhance the utility of the Canal, e.g., container ports, Free Zone expansion.

Even though Panama is under no obligation to use the program for Canal-related projects, it is likely that Panama will use much of it for this purpose.

*Question 13.* Commentators and government leaders in Panama have from time to time raised questions about disputing various accounting practices of the Panama Canal organization. In view of the fact that the proposed Panama Canal Treaty provides for four Panamanian citizens on the commissions Board of Directors and an equal number of Panamanian and U.S. citizens on the Panama Canal Consultative Committee, what prospects are there that the accounting principles which have heretofore governed the Panama Canal will be radically changed? Do accountants in Panama accede to any different accounting principles than does the accounting profession in the United States?

Answer: The management of the Canal operation under the Treaty will remain a right of the United States. The Panamanian directors will have only a minority role in management.

To the best of our information the accounting profession in Panama follows the same accounting principles as its counterpart in the United States. Many members of the best Panamanian accounting firms have been trained in U.S. schools.

Any changes in accounting practices will be at the discretion of the United States in the exercise of its control of Canal operations.

*Question 14.* In the negotiations, the U.S. side must have proceeded with some conception of the extent to which Canal tolls could be raised without diverting Canal traffic or without having counterproductive financial effects. What was the view in the negotiations as to the latitude for raising Canal tolls without diverting traffic or being counterproductive financially?

Answer: Our objective was to insure that any payments to Panama should be financed by Canal revenue. However, we wished to avoid any unnecessary or unreasonable increase in tolls and to avoid raising tolls to the point of diminishing returns. With those purposes and the most expert professional advice available, we agreed upon payments to Panama that we judged to be well within the revenue-producing capacity of the Canal. The basic analysis used to estimate the margin for toll increases was that prepared by International Research Associates (IRA) of Palo Alto, California. In preparing its estimates IRA drew on data from a variety of sources including the Panama Canal Company and shipping companies.

The basic IRA study, prepared in 1975, determined that tolls could be increased between 75 and 100 percent over 1974 toll levels before Canal revenues would cease to increase as a result of toll increases. In order to meet increased costs due to inflation there has been between 1974 and the present an absolute 50 percent increase in tolls.

During the summer of 1977 the Department consulted with IRA concerning the continued relevance of its 1975 study. On the basis of this information it was decided that an initial toll rate increase in the neighborhood of 30 percent once the Panama Canal Commission takes over Canal operations should be well within the Canal's revenue generating capacity.

A more definitive update of the IRA study is in preparation and is expected to be completed early in 1978. We expect this study to provide a more precise estimate of the Canal's revenue generating capacity for the next few years.

*Question 15.* What effect did the resolution adopted by the OAS in June in Grenada have on the negotiations, specifically, Titles III and XIII?

Answer: The Grenada resolution was an indication to both Panama and the United States of Canal user interest in a financially sound Canal operation based on reasonable toll rates. In this respect, the resolution was consistent with the U.S. objective that tolls should cover the costs of Canal operation.

*Question 16.* Canal tolls are subject to the requirements of the Hay-Pauncefote Treaty of 1901. Will that Treaty continue to apply under the proposed treaty relationship with Panama. For what period will the Hay-Pauncefote Treaty apply? Will the Thomson-Urrutia Treaty continue to apply to the Canal? (Article VI of the Neutrality Treaty says it may continue to apply).

Answer: The 1901 Hay-Pauncefote Treaty with Great Britain provides that charges of traffic will be nondiscriminatory and just and equitable. These prin-

ciples are carried over in Article II and III(c) of the Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal.

The Department of State has consulted with Her Majesty's Government concerning the relationship between the Hay-Pauncefote Treaty and the proposed Neutrality Treaty. In these consultations Her Majesty's Government confirmed our view that the proposed treaty is consistent with the Hay-Pauncefote Treaty, which remains in effect.

Concerning the 1914 Thompson-Urrutia Treaty with Colombia, Article III of the Neutrality Treaty authorizes the United States to fulfill its obligation to Colombia under that Treaty to provide toll-free transit to Colombia troops, vessels of war and materials of war. The United States will, of course, fulfill its obligation to Colombia to provide such toll-free transit. It would not have been appropriate, however, for the United States to undertake a commitment to Panama to fulfill United States Treaty commitments to Colombia. (Hence the use of "may" rather than "shall".)

Article VI also provides authority for Panama to continue such toll-free transit privileges and extend them to Costa Rica as well when it takes over operation of the Canal. In the March 1975 Declaration of Panama, the Government of Panama expressed its intention to do so.

*Question 17.* Many statements have been made about user guarantees for the Canal in the proposed treaties as compared to those terms in the present treaty relationship. Please provide a very specific comparison of the present guarantees and those provided in the proposed treaties, and explain the rationale of the wording of the user guarantees in the proposed treaty relationship.

*Answer:* The present standards concerning the operation of the Canal are established in Article III of the 1901 Hay-Pauncefote Treaty between the United States and the United Kingdom and are incorporated by reference in Article XVIII of the 1903 U.S.-Panama Treaty. The proposed Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal carries over the basic principle of neutralization elaborated in the Hay-Pauncefote Treaty and is consistent with the terms of that Treaty.

Most of the textual differences between the 1901 and 1977 Treaties center around the fact that the latter include a series of specific standards, not spelled out in the former, concerning such matters as inspection of warships, requirements to demonstrate financial responsibility to pay for damages, provision for expeditious transit of naval vessels of the Parties charged with maintaining Canal neutrality, etc. (See Articles III and VI in particular). These specific standards reflect concerns of the modern world. At the same time, the new Treaty does not repeat the specific provisions of Hay-Pauncefote concerning such matters as the treatment of belligerent vessels in accordance with pre-U.N. Charter International law and practice, which reflect concerns of the age when the Treaty was drafted.

In addition to these changes in emphasis on specific operating standards, the basic Hay-Pauncefote requirement that the Canal be "open to the vessels of commerce and war of all nations . . . on terms of entire equality, so that there shall be no discrimination against any such nations, or its citizens or subjects, in respect of the conditions or charges of traffic . . ." has been made expressly applicable "both in time of peace and in time of war" under the new Treaty. This reflects the view of our highest military and political authorities that, during wartime, our national security interests can continue to be protected, and our interests in our own use of the Canal better served, by relying on our navy to preclude enemy shipping from reaching the Canal, rather than by giving the Canal operator authority to attempt to exclude them through regulatory action.

Article V of the new Neutrality Treaty also contains a concept not found in the 1901 Treaty. That Article would prohibit foreign operation of the Canal, the garrisoning of foreign troops, and maintenance of foreign military installations in Panamanian territory after the year 2000. This provision was strongly supported by both the U.S. and Panama as a means of putting other nations and groups on notice that neither the U.S. nor Panama would tolerate any attempt to establish foreign domination in Panama once that country assumes responsibility for Canal operation.

As indicated in our answer to question 16 above, the textual differences between the 1901 Hay-Pauncefote Treaty and the proposed 1977 U.S.-Panama Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal do not reflect any change in the fundamental concept that the Canal shall



be open to world shipping on a nondiscriminatory basis, at reasonable tolls. The differences in emphasis indicated above do not reflect any inconsistency between the old treaty and the new. Indeed, the 1901 Treaty would remain in effect along with the 1977 Treaty, and Her Majesty's Government has confirmed that the two are entirely consistent, and that the new Treaty would fulfill U.S. Treaty obligations to the United Kingdom.

*Question 18.* If an interoceanic canal treaty involving guarantees of nondiscrimination and reasonable tolls is violated, what remedies are usually available to any user state of the violation? Would possible remedies of any violation of the proposed treaties be any different than those available under the present Canal treaties? Have any user states made a complaint against the U.S. for unreasonable tolls in the past? If this has occurred, what was the resolution of the complaint?

*Answer:* U.S. experience under the 1901 Hay-Pauncefote Treaty with Great Britain provides a concrete example for the hypothetical issue raised here. Under that treaty, the U.S. has an obligation to Great Britain to maintain only non-discriminatory and just and equitable charges for Canal transit.

Great Britain has never questioned the fulfillment of that obligation. However, had it ever felt that the obligation had been violated, it would have had available to it all of the remedies one nation normally has under international law when it judges its treaty rights to have been violated. On the other hand, the U.S. has never held the view that other user nations have legal rights under the Hay-Pauncefote Treaty, although they obtain benefits from its existence.

Prior to the 1976 toll increase, certain user nations from the West Coast of Latin America did express official concern at the contemplated toll increase. This concern was not expressed, however, in terms of a violation of the Hay-Pauncefote Treaty, but rather as a general appeal on the basis that the proposed increase would be detrimental to their interests. The remedies user nations would have available under the new treaty would be no different from those currently available to them.

*Question 19.* In terms of user guarantees for the Canal, will the accession of user states to the Protocol to the Neutrality Treaty have any effect on the rights of those states with respect to Canal passage? Does the dedication of the Panama Canal to "peaceful transit by the vessels of all nations on terms of entire equality" (Article II of the Neutrality Treaty) ensure the rights of all states?

*Answer:* As indicated above, Article II of the Neutrality Treaty does not confer legal rights on third country users. Under international law, the creation of a third-party right is dependent upon the condition that the Parties to the Treaty should have had a specific intention to confer an "actual right" as distinct from a mere benefit. The United States and Panama had no such intention in the case of this Treaty, just as the United Kingdom and the United States had no such intention in concluding the 1901 Hay-Pauncefote Treaty.

Similarly, adherence to the Protocol to the Neutrality Treaty would not establish in third countries any legal rights with respect to Canal passage. Rather, in adhering to the Protocol, they would, in recognition of the substantial benefits they derive from the treaty arrangements concluded by the U.S. and Panama, commit themselves to observe and respect the regime of neutrality established by the U.S. and Panama and to ensure that vessels of their registry observe the applicable rules. Thus, the Protocol provides third-countries the opportunity to lend both moral and practical support to upholding treaty arrangements between the U.S. and Panama which greatly benefit their own interests. For this reason, third countries would presumably have a strong interest in persuading as many of their colleagues as possible to undertake similar commitments.

*Question 20.* The United States and the Republic of Panama are signatories of a number of international agreements, including the OAS Charter, the Inter-American Treaty of Reciprocal Assistance, and the UN Charter. How do you believe these and other international agreements relate to user guarantees in the proposed Canal treaty package?

*Answer:* The obligations of the United States and Panama under other international agreements such as the Organization of American States Charter and the United Nations Charter do not affect the provisions for non-discriminatory access to the Canal by all user nations under the Neutrality Treaty.

*Question 21.* Article III of the proposed Neutrality Treaty establishes various rules for the security, efficiency and proper maintenance of the Panama Canal.



As a guarantor of the regime of neutrality of the Canal (Article IV of the Neutrality Treaty), does the U.S. have the right to exercise that regime guarantor role if there is violation of the rules stipulated in Article III? Does any U.S. role in assuring the security, efficiency and maintenance of the Canal after the year 2000 extend to any direct rulemaking function?

Answer: Under Article IV of the Neutrality Treaty, the United States would have the right to take appropriate action to ensure that all aspects of the regime of neutrality including the provisions of Article III of the treaty are maintained permanently. This role for the United States would not extend to direct involvement in the formulation of the rules of transit foreseen in Article III(a) during the period of Panama's responsibility for Canal operations. However, should Panama formulate rules that are not just, equitable and reasonable, or that are beyond those necessary for safe navigation and efficient sanitary operation of the Canal, or are otherwise inconsistent with the terms of the treaty, the United States would be in a position to challenge such rules as a violation of its treaty rights, and would take appropriate action to assure that the rules be brought into conformity with the stipulations of the treaty.

Mr. METCALFE. Thank you, Ambassador Linowitz.

I will ask each of my questions of the entire negotiating team unless it is specifically addressed to one of the negotiators.

You indicated in your answers for the record that the Hay-Pauncefote Treaty will apply while the United States runs the canal. Will it apply thereafter, after the year 2000?

Ambassador LINOWITZ. Yes, sir.

Mr. METCALFE. If a new study of canal tolls showed the tolls could not be raised beyond 25 percent or so, would you recommend that this subcommittee implement the treaty to hold tolls to that level?

Ambassador LINOWITZ. I think there ought to be sufficient flexibility so as circumstances require, appropriate action can be taken to recognize the conditions as they exist rather than having a specific toll specified by legislation or authorization.

Mr. METCALFE. Thank you, Mr. Ambassador.

Was it the assumption of the U.S. treaty negotiators that the proposed Panama Canal Commission would have a financial character similar to the present Panama Canal Company?

Ambassador LINOWITZ. The same position? Was that the word?

Mr. METCALFE. Same financial character.

Ambassador LINOWITZ. The same financial character to the extent the revenue will take care of all expenditures. That is the regime that exists today.

Mr. METCALFE. Ambassador Bunker, on page 7 you partially answered the following question. I would like you to expound upon it, if you will.

If before the year 2000 the Panama Canal were closed by a natural disaster, or otherwise, would the United States have any obligation to pay Panama the 30 cents per net ton referenced in article XIII of the Panama Canal Treaty?

Ambassador BUNKER. No, it would not, Mr. Chairman.

Mr. METCALFE. Am I to understand from the material sent to the subcommittee that some appropriations will be required due to the treaties? Could you specify the appropriations? I think you do so in your statement.

Ambassador LINOWITZ. Is there specific reference in the ambassador's statement to this?

Mr. METCALFE. Yes. I wanted him to be specific.

Ambassador LINOWITZ. I think the import of Ambassador Bunker's statement was to make these payments. Appropriations would not be required to make the annual payments to the Panamanian Government in the new treaty.

Mr. METCALFE. Would not be required?

Ambassador LINOWITZ. Would not be required.

Ambassador BUNKER. No.

Mr. METCALFE. Ambassador Bunker, you state on page 6:

All payments are to come from Canal revenues.

Yet, on page 10 you seek authority to borrow from the Treasury and, to quote you again:

... seek appropriations.

What happens if Canal operations are insufficient to meet such obligations?

Ambassador BUNKER. If they are insufficient in a given year, we would want authority as the Panama Canal Company has now to borrow from the Treasury which would be repaid in subsequent years, from subsequent years' operating revenues.

Mr. METCALFE. How would you repay that?

Ambassador BUNKER. As we have done previously, from future year revenues. We have had, as you know, deficits in several of 3 years and tolls were raised when the Canal was not operating at a surplus.

Mr. METCALFE. Mr. Zeferetti, have you any questions?

Mr. ZEFERETTI. Thank you, Mr. Chairman.

Gentlemen, I thank you for your extended statements. I have just a few questions. Maybe you can help me with them.

One, you say that the treaty arrangements state that the tolls must be just, reasonable, and equitable.

What would prevent Panama from, sometime in the future, making their own interpretation as to what constitutes just, reasonable, and equitable rates and raising them?

Ambassador LINOWITZ. The reference to just, reasonable, and equitable tolls is contained in the treaty. We are a party. As such, we have an interest in the level of tolls. If tolls were established at a level which we regarded as not just, not reasonable, and not equitable, we could take whatever action necessary which would include remonstrating with the Panama Canal—

Mr. ZEFERETTI. Who would oversee this? An American agency?

Ambassador LINOWITZ. No, that would be just during the time that the United States is responsible for canal operations from now until the year 2000.

Mr. ZEFERETTI. What American agency? What governs them? Would they fall under U.S. laws and statutes?

Ambassador LINOWITZ. Under legislation which would come out of the Congress. Congress would have fixed responsibilities for setting up this Commission and for making some important determination with respect to the authority of the Commission.

Mr. ZEFERETTI. Also, Mr. Ambassador, you say you have secured basic assurances of nondiscriminatory access to the canal in the treaties. What about after the year 2000?



Mr. LINOWITZ. That continues indefinitely. It is covered in the neutrality treaty which is a permanent treaty.

Mr. ZEFERETTI. You believe don't you that the Canal should be capable of creating their own revenues in order to pay back all the loans?

Ambassador LINOWITZ. Yes, sir.

In making the agreement, we relied upon the best expert guidance we could get and we were advised that the arrangement which had been worked out would permit us to use canal revenues in order to meet the requisite obligations.

Mr. ZEFERETTI. I think, Ambassador Bunker, you say that if the revenues which are brought in do not meet those requirements, you have a way of raising the tolls at that particular time to generate that kind of revenue or——

Ambassador BUNKER. Yes. We have done that previously.

Ambassador LINOWITZ. There are three things you can do. We can raise tolls. There is a limit. You cannot do it indefinitely. The Commission could achieve economies, and we could exercise borrowing authority which would permit us to get over an interim period until once again there was sufficient revenue available to take care of all the obligations.

Mr. ZEFERETTI. One more, Ambassador Linowitz.

You say the principles in the proposed neutrality treaty provide assurance to the United States continued nondiscriminatory access.

Should we not have a little more than nondiscriminatory access to that canal? Shouldn't it read "priority"?

Ambassador LINOWITZ. We do in terms of our movement of our warships?

Mr. ZEFERETTI. Should not that word be "priority" rather than "expeditious passing"?

Ambassador LINOWITZ. We have defined it in our understanding with the Panamanians. "Expedition passing" means getting through the canal with expedited treatment and to go to the head of the line whenever necessary.

Mr. ZEFERETTI. Thank you.

Mr. METCALFE. For the benefit of the Members who came in late, I would like to advise you that we are operating under the 5-minute rule.

I now recognize the gentleman from Kentucky, Mr. Snyder.

Mr. SNYDER. I ask unanimous consent to present additional questions for the record in case I do not have time to get through with the questions that I have.

Mr. METCALFE. Without objection, it will be so ordered.

[The questions of Mr. Snyder for witnesses of the Department of State are contained in appendix B.]

Mr. METCALFE. You will proceed.

Mr. SNYDER. The money that has been pledged to Panama in the treaties, how will this be transferred to Panama? I would like you, if you would in responding, to compare it with the present method where the \$2.3 million goes, not to Panama directly, but to New York banks where it is pledged as collateral or some such for loans they made to Panama.

Ambassador LINOWITZ. Is your question how it will be transferred to Panama?

Mr. SNYDER. Yes; how will it be transferred to Panama and, in that respect, compare it to the present system where they now give it to New York banks in return for loans. I guess it is collateral.

Ambassador LINOWITZ. I do not think we addressed it.

Mr. SNYDER. I am asking you to address it. I would be glad to let the gentleman behind you respond if he wants to.

Ambassador LINOWITZ. I would rather stick with my answer. We have not yet decided how to do it.

Mr. SNYDER. So it could go directly to Panama or to the banks as collateral?

Ambassador LINOWITZ. If the Commission so determines. Maybe Mr. Cooper, Under Secretary of State, might comment on that.

Mr. SNYDER. All right.

Mr. COOPER. I think the payments have to be made to Panama. How Panama chooses to direct them is up to Panama. The salary that the Government pays me goes directly to the bank. It does not come to me. Similarly by agreement with Panama and some of the creditor banks, the two point some million dollars——

Mr. SNYDER. I may be in error. I did not know that the Government would accept an assignment of your salary.

Mr. COOPER. It goes into deposit into my account in the bank. That is done routinely.

The payments are to be credited to Panama and how Panama chooses to use it, which particular operation Panama wishes to choose to use it for is up to Panama.

Mr. SNYDER. Would any of you give us in general amounts Panama's indebtedness to U.S. banks and terms of repayment, as you understand it?

Ambassador LINOWITZ. We understand the total obligation is \$355 million.

Mr. SNYDER. Do you have any understanding as to the terms of repayment?

Ambassador LINOWITZ. No; but I am sure we could get those. I do not have them.

Do you?

Mr. SNYDER. If they are available, I would like to have them submitted for the record.

Mr. COOPER. I am not sure we can get them. This is between creditor and debtor. This is not a matter in which the U.S. Government has a direct interest between the lender and borrower if you are talking about the details on maturity.

Mr. SNYDER. It is our understanding that 40 percent of the Torrijos regime's budget is pledged to debt service——

Ambassador LINOWITZ. About 32 percent.

Mr. SNYDER. Has that been reduced, Mr. Linowitz?

Ambassador LINOWITZ. Well, it is the figure which we have now.

Mr. SNYDER. There is no agreement, on or off the record, that any of this money that you have referred to in your testimony is pledged to this debt service or to any financial interest, to the best of your knowledge?

Ambassador LINOWITZ. Absolutely right.

Ambassador BUNKER. Right. Right.



Mr. SNYDER. Ambassador Bunker, you have referred, and I think another witness too, to the possibility of the canal closing because of some phenomenon and not having the revenue coming in to meet the commitments, and I believe you said you would seek borrowing authority from the Treasury until the time that revenue is again generated.

Ambassador BUNKER. It is similar to the borrowing authority we have now.

Mr. SNYDER. It would not permit you to borrow for the purpose of the Commission? You would have to get new authority from the Congress to do that?

Ambassador BUNKER. Yes.

Mr. SNYDER. If the Congress would not give you the authority, what would you do?

Ambassador BUNKER. I do not know what we would do. We would not be able to make the payment. We would have to make it up in the future.

Mr. SNYDER. I think my time is up.

If you do not make the payment, how would you get the services pledged?

Thank you, Mr. Witness, and thank you, Mr. Chairman.

Mr. METCALFE. Thank you, Mr. Snyder.

At this time I call on the distinguished chairman, Congressman Slack.

Mr. SLACK. I have no questions.

Mr. METCALFE. The gentleman from California, Mr. Robert Dornan.

Mr. DORNAN. Mr. Chairman, I was late. Could I defer to some of the more senior Republicans?

Mr. SNYDER. Would you yield the time to me?

Mr. DORNAN. I would use my time, but there are committee members here from the full Merchant Marine and Fisheries Committee, and since they were on time, may I defer to Congressman Treen or Congressman Bauman?

Mr. METCALFE. Mr. Treen.

Mr. TREEN. Thank you, Mr. Chairman. I appreciate being able to participate even though I am not a member of the subcommittee.

I have a few questions. First of all, what happens if the extra treaties and guarantees are not agreed to by the Congress? What happens to the basic treaty structure if that is not approved?

You have said, Mr. Linowitz, on page 6:

We made it clear to the Panamanian negotiators that any arrangements to assist with Panama's development were to be separate from the Canal agreements and were in no way to be tied to the rights and obligations of the United States and Panama under the Panama Canal Treaty and the Neutrality Treaty.

How is this made clear? What are the consequences if Congress does not guarantee the loan?

Ambassador LINOWITZ. It was made unmistakably clear by us that the treaty stood alone, and the economic package was separate and apart.

Mr. TREEN. In what form? Was it verbal or in writing?

Ambassador LINOWITZ. I do not know if we put it in writing. We made it clear orally. In a number of our discussions it was clearly emphasized.

Mr. TREEN. There is no protocol or anything in writing which makes clear that the United States intends to obtain these loans, loan guarantees, or credits; but even if the United States is not successful with respect to the Ex-Imbank, with respect to Congress, that the treaties still will have the full juridical impact?

Ambassador LINOWITZ. If the treaties were dependent upon the package, they would have said so. They did not. This said "best efforts." In other words, we made it clear in every way possible and the Panamanians so understand that the treaty stands alone. They understand that if it is ratified, it becomes effective whether or not there is approval of the economic cooperation package. We would regret exceedingly if there is not such an approval because it is in our highest interests.

Mr. TREEN. I am not disagreeing with the point. I might at a later time. I am trying to get facts. There is nothing in writing between the two Governments that makes it explicit that the loan guarantees and credits have no effect on the treaty?

Ambassador LINOWITZ. There is a note written by Cyrus Vance to the Panamanian Ambassador that makes no reference at all to the treaty in discussing the economic cooperation package. It says, "I am authorized to inform you that my Government is prepared to agree within limitations of applicable U.S. legislation and subject to applicable legal requirements and, where necessary, to availability of the appropriate funds to the following:". And then it goes through it.

Mr. TREEN. I understand.

The flat \$10 million, that is to be paid regardless of the revenues of the canal. If the canal were closed by some catastrophe, the \$10 million must still be paid; is that correct?

Ambassador BUNKER. No. Each of the annuity payments must be paid from canal operating revenues according to the treaty.

Mr. TREEN. On page 8 of your statement, Ambassador Bunker, the third to last paragraph, you refer to the difficulty of estimating in advance the cost to Panama of providing these services. Article III specifies that after the first 3 years, the amount of reimbursement may be adjusted to reflect inflation and other relevant factors.

Who will make the decision after the third year? The Panama Canal Commission, or will that be negotiated by the two Governments?

Ambassador LINOWITZ. The question, sir, I think that you are addressing is how does the determination get made with respect to what are the factors that are relevant, and how is that determination reached. Is that it?

Mr. TREEN. What factors are relevant and who would determine the actual payment level on the services?

Ambassador LINOWITZ. Perhaps this would be helpful.

We have specifically demanded the insertion of the words "and other relevant factors." The Panamanians ask for a factor which would take into account inflation. It was our strong feeling it was only a one-sided arrangement. It might be well that the costs would be significantly less than the \$10 million we agreed to pay. They might be able to do the job more economically, in which case we would want to adjust the payment down. This would be done by the Commission.

Mr. TREEN. The Commission would have full authority?



Ambassador LINOWITZ. Yes.

Mr. METCALFE. The gentleman's time has expired.

I recognize the gentleman from Mississippi.

Mr. BOWEN. No questions.

Mr. METCALFE. I recognize the gentleman from Minnesota, Mr. Oberstar.

Mr. OBERSTAR. Thank you, Mr. Chairman.

I have supported the concept of the treaty, and I complimented both Ambassadors for the presentation in August. I think it restored the responsible position of the United States with respect to our American neighbors to the south.

I think that the real issue of the Panama Canal Treaty has to do with the future relationship of the United States with our American neighbors south of us.

There are some questions that people raise about the content of the treaties and obligations of the United States incurred by the treaties, which I think, if carefully and fully answered, will bring about the wider support of the American public which the administration needs to win ratification of the treaties.

I found in my own district when I fully explained the treaties both as to the history of the U.S. Government in the establishment of the Government of Panama and the present relationship of the Panama Canal to our economic and military requirements, people supported the concept of these treaties.

They raise a question about many numbers which have been cited in the press. The numbers are these, \$345 million for economic and military assistance over a period of 10 years outside of the treaties, I believe; and \$752 million unrecovered investment referred to in testimony to be presented later today by the Comptroller General. That is about \$1 billion.

People ask why do we have to make that payment or make that contribution to Panama in order to give up the canal.

They ask why do we have to pay \$46 million a year to the Government of Panama, and I would like you to respond to this question.

Ambassador LINOWITZ. I think in the first place, sir, it is important to pull apart those concerns so that we can deal with them effectually. It is of vital significance that the economic cooperation and military assistance program is understood to be not a grant, new loans, guarantees, or insurance. In other words, this is not going to be a payment to Panama, but it is making available to them on terms and conditions which are established for all other countries, funds which will help them in their economic development and help them to build up their defenses so they can help defend the canal when the time comes.

We believe it is very important for people to recognize that from now to the year 2000, we will continue operating and maintaining the canal. We will continue to have the use of it as we have in the past. Everyone recognizes that we have paid a small annual sum for the use of Panama proper. We are paying \$2.3 million a year. That is an increase several times over the original \$250,000 a year.

We have had a bargain in terms of the U.S. payments to Panama in contrast to payments we make to other countries for use of their land.

The third point is that we are going to continue having use of the

canal. We have a right to access. We are not washing our hands of Panama. The treaty is a fair one. It takes care of the Panamanian requirements. It fully represents our interest and does not represent a bribe or a kind of effort to give the Panamanians more than they were entitled to.

They asked large sums, \$1 billion down first, then \$500 million, then \$300 million a year based on comparisons of what we were paying other countries for use of their land.

They finally accepted the basic proposal we put forward.

Mr. OBERSTAR. How does the Panama economy rank with respect to the economy of other Central and South American countries?

Ambassador LINOWITZ. Mr. Cooper wanted to make a comment.

Mr. COOPER. I want to address the first question.

What was the background of this very extensive U.S. investment in the Panama Canal? We have had the use of the Panama Canal for 65 years. We expect under the treaty and beyond the treaty period indefinitely to continue to have the use of that. The U.S. investments originally and improvements were for the provision of the service. It was never anticipated at any time that I am aware of that the capital should be paid to the U.S. Government. On the contrary, Congress at various points along the way created the structure where the expectation was explicit that the capital would not be returned. The benefits to the American public have not come through profit on original investments, but through a transportation facility which has been extremely valuable to our own country economically and for national defense purposes. Our return is to be measured in those terms rather than in terms of a financial return.

It is worth recalling that in the early 1950's when there was legislation changing the financial structure of the Panama Canal Company, no provision was made at all for the return of the original investment.

Mr. METCALFE. The gentleman from Maryland, Mr. Bauman.

Mr. BAUMAN. I would respond to the Secretary by saying that it was indeed never anticipated that we would have a full repayment of our capital investment; neither was it seen by Congress that any administration would relinquish control or abandon ownership of the canal. Many original bases of thinking have gone by the boards.

I will ask this question simply because it is being asked by a great many Americans.

The present worth of the Panama Canal based on book value is about \$502 million for the Panama Canal facilities and \$60 million for U.S. Canal Zone facilities, but the Governor has estimated the replacement value is \$3.5 billion.

In addition to the 30 cents net ton fee to be paid, we are agreeing to \$10 million payment annually, and there have been various estimates given from time to time as to what the total amount will be which the United States will pay throughout the term of the treaty.

Various Senators dealing with the figures and the other figures which you presented came up with a total amount of \$1.32 billion to be paid. However, the Economic Minister of Panama estimated \$2.26 billion in 1977 dollars which would eventually be paid to the Government of Panama.



If, indeed, we are giving this away, why are we paying the Panama Government to take our property? Is this a bribe to get them to agree to the political part of the treaty with which you gentlemen seem so enamored?

Ambassador LINOWITZ. Are you addressing that to anyone?

Mr. BAUMAN. Whomever can answer. We heard you in August. We will be glad to listen.

Ambassador LINOWITZ. We do not look on it as a giveaway. Let us be precise about language. There is an agreed amount to be paid per year while we continue to run the canal. When they get the canal, we pay them nothing.

Mr. BAUMAN. We are paying them a fee for our operation and, in addition, we are paying them a per tonnage fee for the amount of shipping?

Ambassador LINOWITZ. We, as such, are not paying. The canal operations will pay a certain amount coming from the use of the canal. That is where the 30 cents per ton comes from. It is very important to keep that arrangement in line.

Mr. BAUMAN. The economic issues are not divorced from the political issues.

We are paying them over and above the enormous cost of this canal in lines and fortunes; we are paying them to agree to take this off our hands until they can run it.

Ambassador LINOWITZ. I would agree until you got to the other words. I agree that political issues and economic issues are intertwined. They were both part of the same treaty. We worked out a treaty which was fair and reasonable and in the national interest.

Mr. BAUMAN. Has any agency of the United States done an analysis of the negotiations conducted this summer and the impact on the economy?

You said that 32 percent is devoted to debt service. Other figures show 40 percent. Panama has a \$1.5 billion national debt. Their inflation rate has been as high as 25 percent—15 to 10 percent in the last year. They turned to the Soviet Union to buy their sugar. The Soviet Union has certain other negotiations going on for the building of plants and a factory for sugar refining equipment, and they are going to establish a bank.

Has any analysis been done of the economic dependence of Panama on the Soviet Union as a result of these recent negotiations? If not, why not?

Ambassador LINOWITZ. Mr. Cooper can comment.

So far as we know, no agreements were reached. It was only a preliminary discussion.

Ambassador BUNKER. Preliminary discussion.

Mr. BAUMAN. No analysis was made of what this might mean?

Ambassador BUNKER. Since the preliminary discussion did not come to anything, I don't know what we would analyze.

Mr. BAUMAN. You would wait until the troops are there?

Mr. METCALFE. Your time has expired.

The gentleman from Washington.

Mr. PRITCHARD. Thank you, Mr. Chairman. I want to thank you for allowing us to sit in.

You touched on the fact, one of the reasons that made the costs go up so radically is the fact that we have made very large payments to people in other countries around the world where we have our bases. I don't personally agree with this as a policy——

Ambassador LINOWITZ. May I please respond, sir?

Mr. PRITCHARD. Yes.

Ambassador LINOWITZ. That is what led them to make their original demand.

Mr. PRITCHARD. Yes. It created a situation for us to say that \$10 million is a good payment.

Ambassador LINOWITZ. The thing that I would stress is that the figure that was finally arrived at was the figure that we had put forth.

Mr. PRITCHARD. What is it that we pay to say Turkey? Do we have a figure?

Ambassador LINOWITZ. Yes; we do, sir.

Mr. PRITCHARD. And also the amount of land we rent from Turkey for these purposes?

Ambassador BUNKER. I think over a 4- or 5-year period the total comes to about \$1 billion, of which \$200 million will be for military assistance grants.

Mr. PRITCHARD. It seems when we are dealing with Panama and this amount of money, the problem is the amount of money that we pay to other nations. It is the perception of another country as to what is the going price in the world when America goes out and rents acreage. It is a policy which I think leads us into serious trouble. It does raise the perception of other nations as what we will pay.

Ambassador LINOWITZ. Yes, sir. We do not accept that analogy, but they do.

Ambassador BUNKER. They cited it to us.

Mr. PRITCHARD. I am sure they did. It is a shortsighted policy in our country. We are starting down the road with nations who have a great deal to gain by our staying in there and being their protector. In many ways we are performing a far greater service for them than a comparable situation in Panama.

When you talk about inflation, you have written this into the contract, that inflation will be a factor in all computations of what we are going to pay.

Ambassador LINOWITZ. The adjustment will be based on the Wholesale Price Index for all manufactured products starting the day after the treaty goes into effect.

Mr. COOPER. Only on the royalties.

Mr. PRITCHARD. That is what I am talking about. Some of the financial factors are based on coming to an agreement today. I think you recognize that we are getting into a political year. I guess we are always in a political year. It may be that the Senators will not want to take up this sticky bone. If they do not, then we have already committed ourselves.

First of all, I guess there are two factors.

One is the money factor. If you have inflation going and it is held up for a couple of years, what is the actual effect?

Second, of this inflation on the total cost given some lapse of time before the treaty is signed, what happens if we are unable to approve



this for a couple of years? Can this drag on? I know this is not something you would like to talk about or think about.

Ambassador LINOWITZ. We have indicated to the Panamanians we will in good faith do everything we can to assure ratification. This would mean moving with all speed in order to obtain the requisite ratification and, later, the implementing legislation required so we can make the treaties effective.

I think that is what they are expecting. It would be pure speculation for us if we said how they would react if it were not approved. We would have reason to anticipate that some things would take place that would not be good for our relationships with Panama or the Panamanians.

Mr. PRITCHARD. All right, thank you.

Mr. METCALFE. Your time has expired.

We passed a resolution permitting nonmembers of the Committee on Merchant Marine and Fisheries to ask questions. This referred to Congressman Slack.

I would ask unanimous consent that we make the same resolution to extend the privilege to Mr. Clausen of California if he cares to participate.

Hearing no objection, I call on Congressman Clausen.

Mr. CLAUSEN. I would ask unanimous consent that I be permitted to submit a copy of my perspectives on the Panama Canal and the treaties in question.

Mr. METCALFE. There being no objection, it is so ordered.

[The following was supplied for the record:]

[From the Congressional Record, Oct. 6, 1977, vol. 123, No. 160,  
House of Representatives]

#### PERSPECTIVE ON PANAMA

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from California (Mr. Don H. Clausen) is recognized for 30 minutes.

Mr. DON H. CLAUSEN. Mr. Speaker, I wish to present today to my colleagues, a matter of great concern—a "Perspective on Panama" as I see it.

I do so in the hope that my sharing some of my experiences in the "negotiating process" relating to political status questions during my service on the territories subcommittee of the House and as a member of the Ad Hoc Advisory Group on Puerto Rico will be helpful to the congressional process.

I will attempt to relate where I have seen the negotiating process fail in the course of the Puerto Rican negotiations and also comment on the lessons to be learned from the very successful negotiations with the Marianas covenant which were carried on with the full support and knowledge of the Members of the House and Senate having jurisdiction over and responsibility for the legislative matters that were to be involved.

The Panama Canal and the proposed treaty are the subject of much discussion, confusion, distortion, dissension, concern, and debate—throughout the country and in the halls and cloakrooms of Congress.

While the ratification of international treaties is the traditional and constitutional responsibility of the U.S. Senate, there is a growing body of opinion in our country, as reflected in the communications to my office, that the American people want and, indeed, expect the full Congress—the House and the Senate—to be involved in the Panama issue. A very emotional issue, I might add, both here and throughout Latin America. You have heard and read multitude of comments such as: "We bought and paid for it, don't give it away" or "If the Treaty isn't approved—there will be guerrilla warfare all over the Western Hemisphere."

These are but two examples representative of the extreme points of view.

Tonight, I would like to share a few thoughts with you and, hopefully, give you a little different "Perspective on Panama".

## NEGOTIATING PROCESS

I would like to share some thoughts and concerns I have with regard to the "negotiating process," some chronological and historical data; what some of the people in Washington are saying; what the alternatives are if the treaty is not approved in its present form, and; finally, why I think we need a new approach to our relations with Panama and all of Latin America—including the resources, security, and stability of the Western Hemisphere.

[The "negotiating process" on the Panama question, really "leaves me cold" and in my view is the major contributor to the problems we face in dealing with this controversial issue.

This process started in the Johnson administration, in response to the riots in Panama during the midsixties, and was carried forward through the Nixon, Ford, and Carter administrations.

My fundamental disagreements with the "negotiating process" are, I believe, consistent with expressions most often heard from the American people.

What are they saying?

"(1) As my elected representative in Congress, don't give away the canal.

"(2) What are we doing negotiating with a nonelected military dictator?

"(3) What do the *people* of Panama really want and have to say about their future destiny and political status?

"(4) What do the people of the United States really desire in the way of a relationship with Panama?"

What do I read from all of this? My people want me to be involved in the process so as to express their concern and point of view.

They find it difficult to accept a "negotiating process" that regulates the U.S. House of Representatives to a followup role of having to vote to "pay the bills" for a vital economic and security package which was drafted by others and which the House had no opportunity to approve or reject.

The bitter experiences of Vietnam, starting in the early sixties and escalating in the midsixties by unilateral Presidential action is another case in point where the Presidents of that era took the action and then said to Congress "pay the bill."

This costly experience has caused the American people to demand a check and balance effort from the Congress.

They want us to be consulted and more involved in the total process.

They want us to be fully involved in the process during the negotiations and not be put in the position where: "you've got to accept what has been negotiated by the Executive because, to reject it, would cause embarrassment to the President and the country."

I say it is ridiculous even to suggest that the Congress must accept a position the executive branch has announced just because someone might be embarrassed.

I have seen successes and failures in the negotiating process.

The failures occur when Presidents try to go it alone without adequate consultation, advice, and involvement in the negotiating process with the Congress.

Our most successful ventures in foreign policy are those that had maximum involvement and cooperation between the Executive and the Congress—because all know they would be held accountable to the people that elect them.

Panama has the potential for failure unless they revise and/or establish this type of joint negotiating process.

I am in the process of communicating my strong concerns to the Members of the Senate.

For one experienced in Washington politics, the current dissention on Capitol Hill over the ratification of the new Panama Canal Treaty was fully predictable. My committee assignments in the House of Representatives—Public Works and Interior and Insular Affairs—provide an opportunity for me to participate actively in international negotiations and to deal with Inter-American affairs. I know that international political negotiations are apt to succeed only when both branches of Government act as coparticipants.

## PUERTO RICAN EXAMPLE

For example, in 1972, the President appointed me to the Ad Hoc Advisory Group on Puerto Rico. The President charged us to meet with our Puerto Rican counterparts to hammer out a new political status for the island. Three years later, hard work, a draft compact of free association was developed and pre-



sented to the U.S. Congress for enactment. Unfortunately, from the start, the compact was doomed to fail. Although the document was sensitive to the political and cultural aspirations of Puerto Rico, the details—especially the intricacies of tax, trade, and immigration matters—were hazy at best. Why? Throughout the negotiations, the executive branch failed to supply the mainland negotiators with the expert advice and administrative experience necessary to fashion a compact in consonance with legal precedent and Federal practice. Accordingly when put to the scrutiny of various congressional committees and Federal agencies, discrepancies emerged of sufficient magnitude to kill the draft compact. In other words, of the two pillars upon which successful negotiations must stand—political sensitivity supplied by the Congress and administrative expertise afforded by the administration—input from the executive branch was absent.

In addition to the inadequacy of the administrative expertise furnished by the United States, the makeup of the Puerto Rican delegation clearly was not representative of the major established political interests in Puerto Rico at that time.

In spite of the good faith of all concerned and the importance of the issue, the Puerto Rican compact could never get off the ground. Although the American system of government is the finest in the world, it is like any other delicate mechanism. To be effective, all components must be operable.

#### MARIANAS EXAMPLE

But all negotiations undertaken by Washington do not end so abysmally. Once again, let me draw again from personal experience.

Following World War II, the United States agreed under the U.N. Charter to administer those Pacific islands, known as Micronesia, which were wrested from the Japanese by American amphibious forces during the war. Many of these island names—Kwajalein, Truk, Peleliu, Saipan, Tinian—will be familiar to many of you, especially if you served as a member of the Armed Forces in those bloody Pacific battles. As a carrier pilot, the Navy first introduced me to the Mariana Islands—one of the three archipelagos that comprise Micronesia. Ironically, and proudly, I might add, it was these same islands—the Marianas that became the ones I assisted, in the determination and development of their own political future, 30 years later as a Member of Congress.

Under the U.N. trusteeship agreement, the United States is obligated to "promote development toward self-government or independence in accordance with the wishes of the people \* \* \*."

The story of the negotiations—the give and take on both sides, the integrity and sincerity displayed by all participants—is too long to relate to this forum. Let it suffice, that in my political experience, I have never witnessed a better example of "working democracy." Within the Federal Government, a special White House office was established to undertake the ramifications of negotiations. Dedicated American officials from the Defense, State, Justice, Treasury, and Interior Departments were brought together to work out the details of this new, innovative approach in American federalism. Within Congress, we were continuously kept abreast of progress in the negotiations. Congressional input into the negotiating process was conspicuous. Following a plebiscite in the Marianas, wherein nearly 80 percent of the people endorsed the covenant's provisions, the President submitted the pact to the Congress for approval. The Congress, having been consulted and kept fully informed from its very inception, had no doubt of the covenant's contents. Here was a negotiated document to which all parties concerned had access—a document freely chosen by the people. Congressional passage was assured. On July 1975, on the floor of the House, I stated:

"Mr. Speaker, although the population of the Mariana Islands is small and the amount of Federal expenditures envisaged is relatively small, the political, legal, and social precedents to be established with approval of the Marianas Covenant are salient. Foremost, a new system of local government, unique in the annals of U.S. history, will be enacted. Secondly, new patterns of economic and social advancement for the undeveloped world will be launched; and finally America's leadership in the Pacific basin takes on a new and very constructive dimension.

\* \* \* \* \*

"Regarding the negotiating process, I wish to commend highly, Ambassador Haydn Williams, the President's personal representative for Micronesian political status negotiations, for the diligence he displayed in keeping members of the Interior Committee informed on progress made throughout the negotiating proc-

ess. \*\*\* In my 13 years as a Member of Congress, I have never witnessed a closer or more cooperative relationship established between the Congress and the Executive Branch."

On March 24, 1976, there was no one in the East Room of the White House with more pride than I as I stood behind President Ford and watched him sign the covenant into law.

#### CURRENT SHORTCOMINGS

At this point, you may be saying, all very interesting, but how does this concern the new Panama Treaty? Although the political status of Puerto Rico, the Marianas and Panama may differ; in all three instances, vital U.S. interests were at stake; namely, America's leadership role in the Pacific and the Caribbean. Moreover, U.S. economic ties with the underdeveloped world hung in the balance. Also, national security interests, specifically, the preservation of air and sea lanes, upon which this Nation is dependent, were in jeopardy. But even more importantly, the lives of people—their freedom of choice were—cogently involved. American citizens, as well as aliens, were dependent upon the good auspices of the U.S. Government to protect their individual rights.

Therefore, with the understanding of the delicacy of international negotiations, it becomes clear that the negotiations of the United States and Panama over the past 13 years have been too narrow in scope in at least two ways.

First, the two groups deliberating as representatives of Panama and the United States were not truly representative, in any sense of the word, of the people of the two nations. For our part, as I have mentioned, the bargaining was done by career diplomats without sufficient input from the legislative branch of our Government let alone the views of the many people and groups in our country who have an interest in the canal issue.

Similarly, the existing regime in Panama has operated its side of the negotiations with a combination of bluff and threat. It needs a broad-based negotiating team that could represent the people of Panama rather than its dictator.

It is rather paradoxical that on the one hand this dictator, who holds his position through power rather than popular support threatens that failure to ratify the treaty will lead to insurrection, sabotage, or guerrilla warfare while on the other hand we are being asked to entrust long-range security interests of future American generations to the good intentions and stability of this regime. If Panama is to have an increased role in the canal, then that role must be one which the Panamanian people understand and are willing to accept.

The Panama Canal is an asset of the Western Hemisphere and should be considered in that context rather than the exclusive property of either the United States or Panama. In my view, the Organization of American States was afforded no more opportunity to influence the contents of the Panama treaties than America's elected representatives in Washington or the people of Panama. To exclude multinational participation in the determining the political and economic future of the Hemisphere is inexcusable.

This short-sightedness in the negotiating process—this callous disregard for the concerns of the people of both Americas—has raised a storm of protest over Capitol Hill. The likelihood of attaining the two-thirds majority in the Senate necessary to ratify the treaties becomes less likely with each day. But if the treaties fail, what next?

Obviously, the relations between the United States and Panama are strained; tensions can be eased only through open and forthright discussion. In the next round of negotiations, we must be assured of a broad base.

There is a very important principle involved. The United States is the major advocate of a free and open society, and has raised concepts of human rights to a level unprecedented in history. We are a government of, by and for the people. Whatever we do in the negotiating process should reflect and project that principle.

As demonstrated in the Northern Marianas negotiations, the United States can no longer rely exclusively on the State Department to conduct proceedings which are politically sensitive at home. Rather an administrative task force—composed of the best political, economic, and military talent available—must be established under the President's personal direction and charged with formulating an agreement that truly reflects the desires of the American people. In the process, both Houses of Congress must be active participants. Similarly, members of the OAS should also be invited to join in. As for Panama, strong international pressure must be placed on the Torrijos' regime to insure that all factions of the Panamanian society are represented at the negotiating table.



## FREE ASSOCIATION

One option might be to form closer political and economic ties with Panama. The concept of "free association" is one receiving more and more attention as nations, whose economies and histories are inextricably intertwined, seek to maintain national identity in a world of ever expanding complexity. Free association involves the recognition of the political dependency of one national entity upon another but simultaneously maintains a discrete legal identity recognized by international law. Such a status becomes increasingly important for small states which have been drawn into a power struggle between the great powers or have an insufficient economic base to support its population. At this moment, for example, the United States and Micronesia are involved in negotiations which, if successful, will establish the free associated State of Micronesia, wherein Micronesia will retain its sovereignty for internal matters while the United States assumes responsibility for the islands' foreign affairs and national defense. It is conceivable that a similar arrangement could be worked out with Panama. In any event, this option should not be overlooked. Of course, any such change in political relationships would require the consent of the Panamanians, freely expressed at the polls.

## AN INTER-AMERICAN PROBLEM

Beyond the procedures of the talks on the future of the canal, however, lies the fact that the canal is not simply an issue affecting Panama and the United States—its strategic and economic importance affects every nation in the Hemisphere.

This is not just a Panama-United States problem but rather an inter-American problem and requires an inter-American solution.

My suggestion is that we begin new and expanded negotiations on the future of the canal and all related economic, political and security matters. These negotiations should be bilateral between the United States and Panama on economic, political status, and operational matters. The security matters should be inter-American in scope and solution, and every interested nation of the Western Hemisphere should be offered the opportunity to participate. The canal is very important to some Latin nations, like Mexico, Chile, and Peru, and is relatively less important to others. The special concerns of each nation should be representing an inter-American solution.

Until such time as a solution satisfying the security interests of the immediately concerned nations, as well as the special interests of Panama and the United States is concluded, the United States can continue to operate on a free access basis just as it has for over 70 years.

This concept recognizes the legitimate economic and security interests of the North, Central, and South American countries, and it is the only course that can offer a final, permanent, and acceptable solution.

It would permit decisions to be made in a constructive atmosphere of give and take rather than under the threat of another so-called "revolution" in Panama, because its rights are supposedly ignored.

My principal objection at this time is the manner in which the treaty was drawn. In this case, it has lead us to the position where our only choice is confrontation. What we really must strive for is coordination, communication, and cooperation between all the countries of the Americas, but in particular we need to communicate to the people of Panama the advantages that will accrue to them through a more mature, fair, and strengthened partnership with the United States.

## REQUISITES FOR SUCCESSFUL NEGOTIATIONS

As I mentioned in relation to the Puerto Rican compact, successful negotiations hinge upon two propositions: First, administrative expertise, and second, political awareness. In the case of the Panama Treaty, we had an over-abundance of technical advice with little sensitivity demonstrated for political questions.

And what of the people—Americans and Panamanians alike? Do the provisions of the treaty meet with their desires? Or, like the Congress, are they merely being handed a fait accompli with all options closed.

Congress has a vital role to play in such proceedings. The President can and should expect the American Congress or the American people to revamp this out-moded style of international negotiations—to endorse procedures similar to

those evoked by the previous administration in formulating the Marianas' Covenant—to open the international negotiating process to the will of the people through their elected congressional representatives.

I am not sure if we know specifically how the people of Panama feel about the treaty or what they really would like to see evolve in the way of an economic and political relationship with the United States.

When you are dealing with a military dictatorship that got its power by force, you cannot be certain what the feelings of the people would be if they were free to express them.

I believe we can move ahead to an improved relationship with the people of Panama through a modernization of the canal which could allow the investment of large economic resources into our future ties with Panama.

This is the message we can and should take to the people of Panama. If we adopt the "negotiating process" I have outlined, we can assure them that our diplomacy will have the necessary institutional stability to insure equitable, fair, and just results.

While this would be an investment in our own interest, it would allow participation from Panamanians that would benefit them in every social, economic, and cultural way.

The gospel I preach—and one many of you have heard me on before—is that the nations of North, Central, and South America have the potential to be totally self-sufficient as a group.

Hemisphere self-sufficiency would be in our best interest and, in my judgment, ought to be one of our primary goals.

In a nuclear age in which security needs and economic values are so closely intertwined and so absolutely vital to our future, and when the requirements for a coordinated, integrated, and balanced international transportation system has never been greater, the United States must plunge ahead, not pull back.

#### A NEW APPROACH

We have a responsibility to demonstrate bold, innovative leadership in our relationship with our hemispheric partners.

The Santa Rosa Press Democrat editorialized that—

"We need a new approach to our relations with Latin America, we need more trade agreements and exchanges of technical assistance."

I could not agree more with this statement.

In discussing U.S. policy toward Latin America, I have often said: "We do not wish to be looked upon as your fathers; we prefer to be your brothers."

Behind this phrase, there is a long history of continuing debate as to what the proper relationship should be between us and our neighbors to the South. That debate spans long periods of our history from the Monroe Doctrine, through the good neighbor policy, and the alliance for progress, up to the present. Each phase of our evolving policy toward Latin American responded both to an assessment of U.S. interests and of the realities of our relationships in the Hemisphere.

The change in our desired role from being "fathers" to "brothers" goes to the very core of our concept of the "mature partnership" we wish to have with our Latin American friends. As I have observed our working relationship during the sessions of the Pan American Highway Congresses I have attended, I have come to the firm conclusion that we are all proud of our national heritage, yet we are also willing to share ideas that will be helpful to all.

Why must we move to this new policy and new diplomatic style?

We have realized that our Latin American neighbors have made great strides in recent years in the complicated tasks of nation building and economic and social change. These nations are increasingly flexing their "muscles of maturity" as they develop their self-confidence, as they thrust ahead in their efforts to modernize, and to bring the benefits of economic growth and social progress to more of their people.

We, too, have assessed our national interests and the realities of contemporary Latin America.

We have come to the conclusion that the special relationship we seek with our Latin American friends must be such, as to assist the processes of change in an atmosphere of mutual respect, confidence, and cooperation.



As this partnership develops and mellows with time, we not only help each other, but strengthen the quality of our political, social, and economic institutions that bind us together in the inter-American system.

In presenting my personal assessment of our relations of the past, I am of the firm opinion that we must all accept a proportionate share of the blame for the problems that have not been resolved in an orderly manner.

Why has this occurred?

In my view, we have all wavered from one extreme to another—all the way from "benign neglect" on the one hand to the "bear hug" on the other.

When we needed each other desperately, we would join together to meet a common threat to our respective interests.

After the threat had passed, we would fail to communicate adequately, to "keep in touch," thereby neglecting to recognize or deal with promptly the increasing problems associated with the challenges of change in this jet-space-technological age.

The result has been smothering paternalism wrapped in a blanket of immaturity, misunderstanding, unfulfilled promises, and mounting uncertainty.

The sweeping changes in world economic conditions imply a sharp increase in U.S. economic interests in Latin America.

In facing these U.S. interests, what is the position of Latin America? What are its goals?

A chief Latin goal remains the modernization and diversification of their economies, via industrialization, including increased processing of raw materials. Latin America's needs for capital and especially technology suggest that it will certainly continue to want foreign investment. But the terms must be right: The investment must be perceived to promote their own goals of industrialization, better balance-of-payments positions, reduced unemployment, technological advance, and the like.

The new economic strength of Latin America has led to a dramatic improvement in its bargaining position vis-a-vis the United States. But it has also laid out the continued needs of the Latins for external markets, especially for their manufactured products, and for infusions of capital and technology.

There is a wide array of options available to the United States and to Latin America.

The special relationship between the United States and Latin America now needs to be a new kind of special relationship, in which each works together to promote global programs of joint benefit to both. A vision of such expanded and diversified progress together should animate United States-Latin American economic relations in the new world economy and policy of the late 1970's and beyond. And since economic issues will almost certainly lie at the heart of the overall United States-Latin relations for the foreseeable future, the realization of such progress could provide the basis for stability and progress throughout the Western Hemisphere for some time to come.

The time has come for all Americans, North, Central, and South, to stand up and be counted on a man-to-man basis—treating each other with mutual respect in a true spirit of brotherly love, as intended originally by our Creator.

We are all constructive, creative, dedicated, and determined individuals and nations.

We must all realize, however, that by maximizing our economic organizational and institutional interdependence, we can greatly enhance our individual and cherished goals of independence. This is, in truth, what has happened in our United States of America. The lessons we have learned in the course of our experiment in functioning democracy have relevance, purpose, and potential application to all the Americas. I sincerely believe the nuclear age and the long term security interests of the United States and our inter-American friends make an improved relationship necessary—the potential for resource self-sufficiency make it desirable, and the projection of economic and political solidarity, coupled with security, organizational cooperation among the Americas will have a very sobering and stabilizing influence on the entire world community.

A new, expanded, and updated "negotiating process" can make this a reality. The concerned, confused, uncertain, and fearful people of the world are "hungry" for this type of bold and imaginative leadership from the recognized "champion of freedom and justice."

I hope and pray the United States will rise to meet this challenge. The potential for action is unlimited. The consequences of inaction can be devastating to the hopes and aspirations of free men and women in every corner of the globe.

Mr. METCALFE. The gentleman from Mississippi, Mr. Bowen.

Mr. BOWEN. No questions.

Mr. METCALFE. Mr. Dornan, you passed on the first round. We plan to go around again because of the importance of the witnesses who are here. Are you ready now?

Mr. DORNAN. Yes; thank you, Mr. Chairman.

Mr. Linowitz and Ambassador Bunker, I would like to discuss the word "indexing," which appears on page 5 of your remarks, Ambassador Bunker.

"An amount equal to 30 cents per Panama Canal net ton, or its equivalency for each vessel transiting the Canal."

Then you say: "The rate for this payment will be adjusted bi-annually to reflect changes in the U.S. Wholesale Price Index for total manufactured goods."

Who was the fiscal conservative on the negotiating team that gave the Panamanians the break that the American taxpayer cannot get from the Internal Revenue Service with respect to indexing? This is a terrific boon to a foreign country that our own citizens do not get. Would you comment on that?

Ambassador BUNKER. The reason for indexing is, the 30 cents would change in value over the years. It might be very little.

Mr. DORNAN. The American taxpayers know that. Why should we give a break to a foreign country that our own people do not have on indexing?

Mr. COOPER. You are putting the question somewhat tendentiously, and where the U.S. Government makes a long-term contract with its own people, we have that—social security pensions have a cost-of-living escalator. It is not an open-and-shut case.

What we have learned in today's world is that where one makes an agreement with respect to money covering a period as long as two decades, one has to make some allowance. I would suggest where we have those internally between the United States, either between individuals, between two private parties or in the case of pensions between the U.S. Government or former employees, we make provision for the fact that the value of the money may be different.

Mr. DORNAN. I am sure you appreciate that is an awfully hard answer to give to a taxpayer who feels overburdened. The people also want to know why the Panamanian dictators get a plebiscite on the canal issue and our people do not get a plebiscite.

Could I ask a question about the garrison of foreign troops and the maintenance of foreign military installations in Panama?

Suppose there is one of these frequent revolutions or insurrections in Panama and, the first day after the year 2000, a new government comes in and there is a garrisoning of Cuban-Soviet troops. What would you think would be necessary for us to do to protect the canal?

Ambassador LINOWITZ. Whatever is necessary.

Mr. DORNAN. Would that include going in with force?

Ambassador LINOWITZ. Whatever is necessary.

Mr. DORNAN. You say, "whatever is necessary." The President has not said that. He would not tolerate troops going in now.

How would that take place in the year 2000 when the ownership and sovereignty succeeded to Panama?



Ambassador LINOWITZ. That is why the reading of this is important. If you read the neutrality treaty, it is a treaty which will be endorsed by a protocol, which means all the countries of the world will be asked to support that United States and Panama are together to be responsible to keep neutrality.

If we were to make a move—charged as we are—we would be doing it so world opinion would have to be behind us.

Mr. METCALFE. The gentleman's time has expired.

We will go around again in the event some of your questions were not asked in the first round.

I would like an answer to this from the Ambassadors.

The Panama Canal Company has deferred some payments to the Treasury in recent years. Should these deferments be carried over to the Panama Canal Commission and recovered by them?

Ambassador LINOWITZ. Deferred payment of interest?

Mr. METCALFE. Yes.

[Discussion off the record.]

Ambassador LINOWITZ. I am advised there was a deficit in fiscal year 1976. This year there was a surplus which paid back a good portion of that deficit. That reduces the deficit to less than \$4 million which will be paid for out of the earnings next year.

Mr. METCALFE. If, when the Panama Canal Commission would go out of existence in the year 2000, Panama owes money to the Commission as they do now to the Company, what would happen at that time, after the year 2000?

Ambassador LINOWITZ. If Panama owes money to the Commission?

Mr. METCALFE. The Panama Canal Company—Commission.

Ambassador LINOWITZ. If I understand it, when the Commission goes out of existence in the year 2000, and if there is money owed by Panama to the Commission, does that obligation continue? I think it does.

[Discussion off the record.]

Ambassador LINOWITZ. Sorry for the delay, but the liability would continue.

Mr. METCALFE. Article XIII of the treaty provides that the canal "shall be turned over in operating condition and free of liens and debts" at the treaty termination.

If the canal is closed before the year 2000, and if the Canal Commission is borrowed to the hilt, is not the United States obligated to pay off or wipe out these debts and to extend funds to put the canal back in operation?

Do we not have the obligation?

Ambassador LINOWITZ. At the end, there are the words "except as the two parties may otherwise agree." The canal would be turned over free of debts, but if moneys had to be borrowed to keep the canal in good operating order and efficient so Panama could accept it and take it over and run it the way it should be run, then the two parties would agree to that, and that would be a continuing obligation.

Mr. METCALFE. Thank you.

My time has expired. I recognize the gentleman from New Jersey, Mr. ZEFERETTI.

Mr. ZEFERETTI. The gentleman from New York.

Mr. METCALFE. The gentleman from New York.

Mr. ZEFERETTI. Thank you.

What are the financial arrangements for the employees of the canal, the American employees, as a result of the complete turnover of the canal? What have we structured? Is there anything in writing that we have guaranteeing pensions, et cetera?

Ambassador LINOWITZ. Article X of the treaty deals with employment for the Panama Canal Commission, and it covers such things as early retirement, and tells about the rights of the employees as they continue under the Panama Canal Treaty.

Mr. ZEFERETTI. You say early retirement. Are you talking about a mandatory retirement system?

Ambassador LINOWITZ. No. Early/optional retirement.

Mr. ZEFERETTI. Do you have any idea what the cost factor will be for the employees that are affected?

Ambassador LINOWITZ. No, sir, I do not. It would depend on how many choose to take early retirement, when, and so forth.

Mr. ZEFERETTI. You have got a consensus of the amount of employees we have, approximately the length of service and age. Would you have an idea as to what we are talking about in numbers in regard to that? We are talking about the year 2000.

Ambassador LINOWITZ. We can get that, sir.

Mr. ZEFERETTI. I would like that to be made a part of the record. We have been advised we are talking somewhere in the neighborhood of \$30 million. Excuse me, \$8.4 million a year for 30 years. Those are the retirement figures that come to mind.

Has anybody heard those figures?

Mr. SNYDER. I have.

Ambassador LINOWITZ. What are they for?

Mr. DORNAN. \$8.4 million for 30 years for retirement coming out of the appropriated funds.

[Discussion off the record.]

Ambassador LINOWITZ. We would like to get back to you with the figures.

Mr. DORNAN. Because I think this is a direct cost to the taxpayer and we would like to have those numbers.

Ambassador LINOWITZ. We will get that for the record.

Mr. DORNAN. Thank you.

[The following was received for the record.]

The cost of the early optional retirement program is estimated at \$134 million over the life of the Panama Canal Treaty.

Mr. METCALFE. The Chair recognizes the gentleman from Kentucky, Mr. Snyder.

Mr. SNYDER. It is my understanding that the World Bank figures show that Panama owes \$1.7 billion to the private banks. Is that consonant with the \$355 million figure you gave me a moment ago?

Ambassador LINOWITZ. The figure we have is \$355 million as owed to private banks.

Mr. COOPER. United States?

Ambassador LINOWITZ. Yes.

Mr. SNYDER. \$355 million owed to U.S. banks, 1.7 billion total to all private banks. Is that correct, all private banks?



Mr. COOPER. Mr. Congressman, I cannot explain the World Bank figure right off, but I suspect in order to reconcile that figure with ours, you would have to include borrowings by entities in Panama other than the Panamanian Government.

Mr. SNYDER. Please clarify that in a written response.

[The following was received for the record.]

The correct World Bank figure for the Government of Panama's total external debt is \$1.1 billion.

Ambassador LINOWITZ. Panama's total disbursed external debt stood at \$1.1 billion at the end of 1976. And \$648 million was owed to commercial banks. Of that amount, \$355 was owed to U.S. banks.

Mr. SNYDER. Maybe the World Bank figures are in error. Now, on another point, I am sure you are familiar with the Library of Congress analysis made at my request on October 27, 1977, which indicates that the Carter-Torrijos statement does not clarify what rights of intervention the United States has if any threat to the canal comes from Panamanians.

After the year 2000, just what can we do if the Panamanian Government decides to close the canal.

Ambassador LINOWITZ. What rights do have if, after the year 2000—

Mr. SNYDER. I will read it to you directly.

However, the Carter-Torrijos statement, while guaranteeing each party the right to act against threats directed at the Canal, also specifies that the United States may not intervene in the internal affairs of Panama. It is not altogether clear that the statement would permit the United States to intervene in the event that the aggression or threat should result in some Panamanian action.

What can we do if some Panamanians decide to close the canal, whether it is done by an insurrection or by the Government?

Ambassador LINOWITZ. Let me read you what the statement says regardless—

Mr. SNYDER. No. I want you to answer this.

Ambassador LINOWITZ. That is not my statement.

Mr. SNYDER. It is Kenneth Merin's statement, who is a legislative attorney with the Library of Congress.

Ambassador LINOWITZ. I respect him, but I have no reason to believe his statement is more accurate than what the parties agreed to.

Mr. SNYDER. All right.

Ambassador LINOWITZ. “\* \* \* shall, in accordance with their respective constitutional processes, defend the canal against any threat to the regime of neutrality and consequently shall have the right to act against any aggression or threat directed against the canal \* \* \*”

Mr. SNYDER. It also says that we cannot intervene in the internal affairs of Panama.

Ambassador LINOWITZ. The next sentence says, “Any U.S. action will be directed at insuring that the canal will remain open, secure, and accessible.”

Mr. SNYDER. That statement will take precedence over the statement that says we cannot intervene in the internal affairs of Panama?

Ambassador LINOWITZ. There is no inconsistency between the two statements.

Mr. SNYDER. There could be.

Mr. METCALFE. The gentleman's time has expired.

I recognize the gentleman from Minnesota.

Mr. OBERSTAR. I would like to resume questioning which I began earlier.

It relates to the economic condition of Panama, and I repeat the question that I asked earlier.

How does it rank with respect to the other countries of Central and South America? Near the top, near the middle, one of the least viable?

Mr. COOPER. There is a serious problem of measurement in addressing the per capita income. It would be ranked at the top in Central America and among the top as far as per capita income is concerned among South American countries. It is roughly \$1,000 a year. Venezuela is substantially higher. A few of the countries are in that league. Most are well below that.

Mr. OBERSTAR. What is its balance of trade with the United States? Deficit or surplus, Mr. Cooper?

Mr. COOPER. Overall, it is a deficit. That requires two further statements of elaboration.

Even in normal times, year in and year out, Panama's overall balance is deficit, and paid for in part in services, notably through the operation of the canal.

In addition, Panama has been running a deficit over and above what can be covered by its service areas.

Mr. OBERSTAR. That is part of what authority?

Mr. COOPER. The bank loans we have just discussed. Panama is like dozens of other countries around the world since the increase in oil prices and the world recession.

Mr. OBERSTAR. What has been the extent of U.S. economic development assistance through our various foreign aid programs, going back to the Marshall plan days, nonmilitary assistance?

Mr. COOPER. I have the figure of \$20 to \$25 million per year.

Mr. OBERSTAR. \$20 to \$25 million total?

Mr. COOPER. I have a figure here—do you have the table here?

Mr. OBERSTAR. What I am trying to measure is the amount of effort made by the United States in the past to develop the economy in Panama, and the relationship of that effort to these treaties, and the incentive provided to future development to Panama to have a stable government so it will not fall prey to some outside influence?

Mr. COOPER. Let us provide that figure for the record. That is cumulative over the years, and not counting military assistance.

[The following was received for the record.]

U.S. economic assistance to the Republic of Panama from the post-World War II period to 1976 totalled \$314.5 million.

Mr. OBERSTAR. What are the resources for economic development assistance to Panama? What development resources does it have?

Mr. COOPER. Total economic and military assistance, loans and grants, \$321 million from 1949 to present.

Regarding the possibilities for development, other than the canal, there are some possibilities that are in a sense related to the canal. Panama is making an effort, and so far, a moderately successful one, to become an entrepreneur area in that part of the world, an entre-



preneur not only for goods, relatively low tariffs, relatively free exchange service, but also in services. They made a conscious effort in the last 5 or 6 years to establish a banking community with some success.

There are now 71 foreign banks operating in Panama. Beyond that, there are their traditional products, such as bananas, although the prospect of long-term development here is limited. There are major comparable resources in Panama which are in the early stages of development at the present time. Then, of course, there is tourism. It is an attractive place partly, again, because of the traffic through the canal, so they have the possibility of becoming a regional service center.

Mr. OBERSTAR. I think that statement is significant for the future of these treaties, and the relationship of the United States and Panama.

The testimony to be presented by the GAO suggests that possible increases in tolls may result in a financial burden on the Government of Panama.

What is your statement as to the effects of relinquishment of U.S. control over the canal to the Government of Panama? What effect do you think that will have on the economy of the Government of Panama? Will it be a net beneficial effect, or is it likely to be a continuing burden?

Mr. COOPER. Answering that question involves forecasting considerable distance into the future, since we will not relinquish operation of the canal for a 20-year period of time. It would continue to be under U.S. management, with increasing Panamanian involvement in the actual running of the canal.

The expectation, I think, is that by the time the canal passes to Panama, the Panamanians will be fully capable of running it on an efficient basis.

Assuming that the Panama Canal continues to be an important traffic link, I would want to know more about the GAO judgments about why this would be wont to be a burden, assuming the transition is done constructively, and the Panamanians run the canal efficiently.

Mr. METCALFE. The time of the gentleman has expired.

I recognize the gentleman from California.

Mr. DORNAN. Were you aware that William Colby admitted in Los Angeles that the Marianas Conference was bugged with electronic listening devices?

Were you aware that Colby admitted that the CIA did bug the Marianas Conference?

Ambassador LINOWITZ. No.

Mr. DORNAN. The Panama Canal has been described as a free-fire zone. Never mind how we deal with the case of Richard Helms. Would you answer concerning the rumors, suspicions, inferences or hints of bugging in Panama, particularly since you were new to the negotiating process, Mr. Linowitz, and you were not familiar with intelligence gathering of a heavy nature.

From your Vietnam experience, Mr. Bunker, were you aware of the rumors or inferences or suspicions about the bugging of the other side?

The Panama Canal Treaty being ten times more important than the Marianas Conference, were you aware of any bugging during the treaty making?

Ambassador LINOWITZ. I wonder if we ought to go into that. We have testified before the Senate Intelligence Committee in closed session. I do not think we ought to get into these questions here.

Mr. DORNAN. I want to know why the American people should not know if we have intelligence information from the other side as a result of bugging.

Let me ask you, then, Ambassador Bunker, have you publicly denied, and I ask this sincerely, I do not know, have you publicly denied the charges made on the Mike Wallace show, that you offered \$3 million to General "Big" Minh to enter the Presidential race in the——

Ambassador BUNKER. I deny that.

Mr. DORNAN. Why should not Torrijos resign and give freedom of the press now, rather than hold it out to the U.S. Senate that he will give his people what they deserve and should have any way only after ratification? Why should we do this before we negotiate with him, rather than after?

Ambassador LINOWITZ. Do you not think it is irrelevant for this Government to suggest that another head of State leave his position?

Mr. DORNAN. Not when he offers it as a carrot, and when you talk about giving him defense money which will go into armed carriers and machine guns which will continue to suppress freedom, with only the Communist Party allowed in the country. I do not think it is inappropriate for me to suggest that he give his people what they should have and deserve now, instead of holding it out as carrot, even if we give the dictator the canal.

Ambassador LINOWITZ. Even if his people do not want it? His people have not suggested it. You have.

Mr. DORNAN. They do not want freedom of information and freedom of press?

Ambassador LINOWITZ. We are talking about the resignation of Torrijos.

Mr. DORNAN. I have on my staff someone from the Panama Canal who tells me that there is a tremendous desire for freedom of the expression and freedom of the press, but how would they ever ask for Torrijos' resignation, without being suppressed and damaged in a dictatorship?

Ambassador LINOWITZ. No international community supports what you say. The only place you have any support is in the Freedom House. Freedom House, despite that, has strongly urged ratification.

Mr. DORNAN. Well, the Organization of American States is sending a team down.

Ambassador LINOWITZ. They are there now.

Mr. DORNAN. A CBS correspondent was physically injured because he wanted to investigate the jail situation. It is ranked with Cuba as a nation with the least amount of freedom.

Mr. METCALFE. Your time has expired. Mr. Bauman?

Mr. BAUMAN. I want to get back to increased tolls and the economic impact.



As I understand it, Mr. Linowitz has been quoted as saying that there is a probability or possibility that the tolls could rise as much as 25 to 30 percent to cover the new expenditures, and avoid a further deficit, if the treaties are enacted. That would be the largest single increase in tolls since 1914.

I am sure that all of you are also aware of the fact that a number of Latin American countries must depend upon the Panama Canal for a large amount of shipping which they conduct in international trade: Chile, 35 percent. Ecuador, 51 percent. Guatemala, 30 percent. Nicaragua, 76 percent. Peru, 21 percent. I will supply these figures for the record.

Mr. BAUMAN. Have any of the agencies of our Government—the State Department or the Treasury—conducted an analysis of the impact which the projected increases you have mentioned would have on the cost of international trade, and also the impact on their economies?

That is part one of the question. The second part concerns Mr. Vance's or Mr. Linowitz's statement made during our hearing last August that there will be no increased taxes on the American people, or other added burdens on the American taxpayer, according to a phrase used by Mr. Vance.

Have you done any analysis of what the U.S. costs will be for the average American, such as the 45 percent in Alaskan oil, if these tolls have to go up under the new arrangements?

Do you have any statistical analysis, both as to the Latin American countries' impact; and if not, would you do it?

Mr. COOPER. The short answer is yes. Studies have been made for the canal company on the impact of toll increases on the United States and other parts of the world.

As far as the general trade is concerned, a detailed study was done on the Commission by the Panama Canal Company, I believe, several years ago. They went into considerable detail, commodity by commodity, as to the impact on trade of an increase in tolls.

I am not aware that that has been translated into impact for the individual countries, like Ecuador, for example, but work was done on the trade effects of toll increases and canal closures in various regions of the world.

As far as the U.S. taxpayers are concerned, rough estimates have been made of the implications given existing trade patterns of a toll increase on the cost of living, and they are negligible, measuring below tenths of 1 percent.

Mr. BAUMAN. Yes, of course.

Mr. METCALFE. In regard to the question of tolls, Governor Parfitt will address himself to it as well, as will other witnesses tomorrow.

Mr. BAUMAN. I would appreciate that.

Mr. Linowitz is already on record for that period.

Mr. METCALFE. Thank you for yielding.

Mr. BAUMAN. This may be peripheral to you but central to American investors.

The Republic of Panama has issued some millions of dollars of bonds which, under the 1904 treaty are guaranteed by the United States to the extent that they would be paid in the event of default of the revenues which the United States achieves from the canal. It is also my understanding that despite the assurances given to some of these bondholders, the treaty is silent on this question, and that, as a result,

Standard & Poor dropped the rating from AA, which is pretty high, to zilch—there is no rating. They have withdrawn it completely.

A number of American investors stand to lose a great deal of money as a result of the absence of any mention of this in the treaty. Are you familiar with it? What is being done about it?

Mr. COOPER. In general, yes. Your implication is misleading. Standard & Poor did not drop the rating; they suspended the rating. It goes back to the question Congressman Snyder asked earlier.

The payments which the United States Panama Canal Company makes to Panama, \$2.3 million, is pledged against certain outstanding Panamanian bonds. The question will arise what happens, assuming the treaty is ratified and the Panama Canal Commission is set up to replace the Panama Canal Company? What happens to those outstanding pledges?

That is a matter for the Panamanian Government. I think they would be well advised to continue to pledge the required portion of the revenues to which it is entitled under the proposed treaty to back those bonds. The issue can be settled to the satisfaction of Panama and the bondholders.

Standard and Poor suspended its rating just because of the uncertainty surrounding this issue until all the arrangements are made.

Mr. BAUMAN. But I want to complete the question.

Mr. METCALFE. We have the unanimous consent request of Congressman Snyder that all members will be permitted to submit written questions in the future.

Mr. BAUMAN. Thank you.

Just following on the tail-end, you say that this is up to the Panamanian Government to decide, but the United States Government, by the original treaty, accepted this obligation, and much of this investment was made by American citizens. And we have been told this treaty will not hurt American citizens.

It is at least incumbent upon the administration to, in some way, indemnify these bondholders if your treaty wipes out the value of their investment. They now face the possibility of losing millions of dollars.

I do not know what position you might wish to take eventually on that, but it should be considered.

Mr. COOPER. I am not aware that that is in the original treaty.

Ambassador LINOWITZ. It is not in the original treaty.

Mr. BAUMAN. I said it was associated with the original treaty.

Mr. COOPER. We will supply the details of this for the record. I was not aware it was part of the original treaty.

[The following was received for the record.]

#### LOAN OBLIGATIONS

With respect to the portion of the present annuity payment pledged against loan obligations of the Republic of Panama, the \$500,000 payment formerly made to the National Treasury of the Republic of Panama is currently paid, under irreversible instructions given by the Republic of Panama to the United States, to the Chase Manhattan Bank, fiscal agent for the Republic of Panama, in connection with a 1962 bond issue which was privately placed with the Prudential Insurance Company.

These assignments of annuity payments result from contractual arrangements between the Republic of Panama, the fiscal agents, and the bondholders and are not obligations of Panama under the existing treaty between Panama and the U.S. Nevertheless, because the fiscal agency agreements and the instructions issued by Panama to the United States refer to payments due under the 1955 Treaty, it



will be necessary to make certain technical changes in these documents to provide for continuation of these payments if and when the 1977 Treaty becomes effective.

As I am sure you are aware, Panama's treaty income would increase substantially under the proposed Treaty and thus payments under that Treaty will be more than ample to provide continued security for these bond issues. We have been assured by the Embassy of Panama that its government has every intention of guaranteeing the continued annual payment of funds necessary to secure the bond issues.

Mr. COOPER. Panama, partly because of what I said in my response to Congressman Oberstar, is very much interested in becoming a financial center. I find it would quash that whole plan, which is a long-term plan, if Panama were to default on its bonds. It is not in Panama's interest in the period where its revenues are expected to rise, not fall. Panama—I am told informally that Panama—and this does not surprise me—will honor the bonds.

Mr. BAUMAN. Perhaps we can get the Soviet Bank to guarantee the American investors' bonds in Panama.

Thank you, Mr. Chairman.

Mr. METCALFE. Thank you.

We have a quorum call.

Mr. CLAUSEN. Yes, I see that.

You have been very accommodating to me, Mr. Chairman. I would like to ask one brief question. I have a great and long standing interest in all of Panama, having been a cosponsor, along with Mr. Wright, on the Darien Gap proposal.

I would like to know from the vantage of your insight with regard to the statement made by General Torrijos that if it becomes necessary, for treaty ratification he would resign. What, in your opinion, would happen if he were to resign? This is hypothetical.

I ask this question on the basis that I have some serious question based on negotiations with a strong personality as opposed to institutional negotiations.

Ambassador LINOWITZ. I will give you an estimate. If he resigned and stood for election, I think he would be elected in the country right now.

But if he resigned and did not, and did it in a manner that was graceful and indicated this was something he was doing for the good of the country, I do not know that there would be any strong reaction.

I think he made the suggestion when Senator Byrd and his group was there indicating that he thought the approval of these treaties was so important that he was willing to do whatever he personally could to insure that he not impose any problems as far as ratification is concerned.

Mr. CLAUSEN. I have been involved in the negotiation process concerning the Marianas as well as Puerto Rico. I have had successes and failures.

To what extent were you involved, to what extent did you involve the legislative branch of the U.S. Government and in what precise terms? I know you will be dealing with the chairman and all kinds of ranking and minority members, but who was involved?

Ambassador LINOWITZ. I would venture to say that we were in touch with and consulted with 60 or 70 Members of the Senate, meeting

in small groups with them, in order to inform them during the course of negotiations what and how we were doing.

#### AFTERNOON SESSION

Mr. METCALFE. The afternoon session will come to order.

We are especially honored to have with us today the Honorable Elmer Staats, Comptroller General of the United States. We remember that the General Accounting Office, which Mr. Staats heads, has worked closely with the subcommittee in the past. In 1975, GAO did a landmark report on personnel policies in the Canal Zone. That report paved the way for some needed changes.

It is my understanding that Mr. Staats has made a personal reconnaissance of the situation in Panama, and so he comes to us today prepared to give us some pointers on how the proposed Panama Canal Commission can work most efficiently and how the interests of the taxpayers of the United States can best be protected.

Mr. Staats.

[The following were the questions posed by the subcommittee prior to the hearing. Responses to the questions are contained in the testimony of the witness:]

#### QUESTIONS POSED THE GENERAL ACCOUNTING OFFICE

##### 1. TYPE OF AGENCY

Article II, Paragraph 3, of the Panama Canal Treaty provides that the United States shall carry out its responsibilities in reference to operation of the Canal "by means of a United States Government agency called the Panama Canal Commission, which shall be constituted by and in conformity with the laws of the United States of America." In order to accomplish the objectives for the Commission set forth in the Panama Canal Treaty and to provide for the most efficient Canal operation, with what laws could the Commission be conformed and what Government form or forms could the 'agency' take? In terms of requirements and accountability for funds and decisions, what would be the ramifications of the alternative forms?

##### 2. PROPERTY TRANSFER

The Panama Canal Treaty and its accompanying documents set out some property which will be transferred to the Republic of Panama upon the entry into force of the treaty, and the transfer of other real and personal property is to take place not later than the termination date of the Treaty. What implications do these transfers have for the accounting procedure in connection with U.S. investment in the Canal enterprise, assets and liabilities, toll charges, and budgeting. What guidelines or methodology might be suggested in order to accomplish the transfer of assets of real property, and personal property, in an efficient and orderly manner?

##### 3. U.S. GOVERNMENT INVESTMENT AND FUTURE CAPITAL OUTLAYS

Article XIII of the Panama Canal Treaty stipulates that the Canal "shall be turned over in operating condition and free of liens and debts, except as the two Parties may otherwise agree." In light of the unrecovered U.S. investment in the Canal (cited as about \$736 million in the GAO 1975 audit of the Panama Canal Company/Canal Zone Government) and the net direct investment of the United States in the Panama Canal Company, which was about \$366 million in Fiscal Year 1976, what implications does the provision have for the accounting and budgeting decisions with respect to recovery of Government investment and future capital outlays and the incurrence of debt by the proposed Commission? What alternatives are available to insure equity to the U.S. taxpayer as well as efficient operation of the Canal in connection with these issues? For each of the alternatives, what assumptions underlie one or all of them?



## 4. DEPRECIATION POLICIES

The Panama Canal Treaty has many provisions which may impact upon the depreciation policies of the Panama Canal Commission. For example, the United States will have "use rights" in lieu of ownership of some assets associated with the Canal-housing, for instance, is transferred to Panama but the U.S. continues to have the right to use that housing for its employees for a period of time. Also, since all assets of the U.S. agency called the Commission will be turned over to Panama in the Year 2000, all assets could be viewed to have a definite economic life. Given these and other treaty provisions, what are the alternatives for a depreciation policy for the Commission and how might such policies relate to the basis for toll charges at the Canal?

## 5. PAYMENT FOR PROVISION OF PUBLIC SERVICES

Section 5 of Article III of the Panama Canal Treaty provides that "The Panama Canal Commission shall pay the Republic of Panama the sum of ten million dollars (\$10,000,000) per annum" for police, fire protection, street maintenance, street lighting, street cleaning, traffic management and garbage collection services. The Treaty also provides that the costs involved in these services would be reexamined every three years after the Treaty goes into effect. What might be suggested as some of the major alternatives for an agreement for provision of services and insurance for the quality of services provided? What guarantee is there that the Commission will pay an equitable fee to Panama for these services?

## 6. CONTINUITY OF POLICY AND ACCOUNTABILITY

The Panama Canal Treaty seems to make no stipulation as to the accounting of Panama Canal finances except as insofar as it references certain obligations of the Commission. What would be the implications of total assumption by the Commission of the accounting policies now followed by the Panama Canal Company? If some of the major accounting and finance policies of the present Panama Canal organization are not followed by the Commission, what are some of the possible ramifications of discontinuity?

## 7. RELATIONSHIP BETWEEN DEFENSE COSTS OF THE CANAL AND THE CANAL COMMISSION

Defense costs in connection with the Panama Canal have been excluded from the present tolls base for a variety of reasons. Given the rationale that has motivated the exclusion of these costs over the years, which reasons for excluding defense costs would still apply under the new agreements, and which would not apply?

## 8. COMPTROLLER GENERAL

What responsibilities does the Comptroller General of Panama, or his equivalent, have under the proposed Treaty? What are the responsibilities of the Comptroller General of the U.S. under the proposed Treaty?

## 9. ACCOUNTING AND AUDITING

Are there differences in the accounting and auditing procedures used by the signatories which could pose difficulties?

## 10. REVENUE

Assuming the treaties are ratified, would revenue from tolls at present rates cover the cost of the operation of the Canal, together with facilities and appurtenances related thereto, as required by the tolls formula enacted by Congress?

## 11. TOLLS

Since it has been estimated that the provisions of the new treaties would require increases in the rates of tolls of somewhere between 25 and 46 percent, or possibly more, and assuming increases in the rates of tolls of that range, what effect would increases of this magnitude have on the volume of traffic transiting the Canal?

**STATEMENT OF ELMER B. STAATS, COMPTROLLER GENERAL OF  
THE UNITED STATES, ACCOMPANIED BY JOHN WATSON AND  
FRANK M. ZAPPACOSTA, ASSISTANT DIRECTORS, INTERNATIONAL  
DIVISION OF THE GENERAL ACCOUNTING OFFICE**

Mr. STAATS. Thank you.

Mr. Chairman and members of the subcommittee: We welcome this opportunity to discuss our observations on the proposed Panama Canal Treaty and its financial and operational implications for the canal.

The General Accounting Office, as you know, is responsible for auditing the financial operations of the Panama Canal Company and the Canal Zone Government. We are currently auditing their accounts and financial statements for fiscal year 1976, the transition quarter, and fiscal year 1977.

We have had a long involvement with these entities, dating back to the establishment of the Panama Canal Company in 1951 as a corporation subject to the requirements of the Government Corporation Control Act. Because of our statutory auditing responsibility and long relationship with the Canal Company and government we have followed the treaty negotiations with great interest. Now that the treaties have been signed and specific future functions and activities of the proposed Panama Canal Commission have been outlined, we plan, as part of our current audit, to analyze the problems involved in the implementation of the treaties.

Governor Parfitt has established a treaty planning committee to guide and coordinate planning for treaty implementation and under the direction of the group, a number of studies are now underway to determine the specific organizational, personnel, and financial impact of the treaty provisions. We have asked for and Governor Parfitt has agreed to provide these studies as they are completed. Until we receive and have an opportunity to analyze the studies we are unable to make any definitive statements on the financial viability of the proposed Panama Canal Commission. Nevertheless, based on our auditing experience and understanding of the treaty, we can highlight some of the issues to be resolved in implementing the Panama Canal Treaty.

In our testimony today we will not attempt to address the impact of the treaty on the U.S. military forces in Panama or the \$345 million economic and military assistance package over the next 10 years which has been arranged outside of the treaty.

The unresolved implementation issues include:

The form of U.S. Government organization that the proposed Panama Canal Commission would take; provision for external audits; transfer of property to Panama, recovery of U.S. investment in the canal, depreciation policy and future capital outlays; treatment of interest currently paid to the Treasury on the interest bearing investment of the United States; treaty payments to the Republic of Panama; resolution of Panama's debt for past services; increased benefit payments to employees for repatriations, early retirements, and relocations; and the impact of the treaty on toll rates.



Form of U.S. Government organization: The treaty is silent as to what form of organization the proposed Commission would take—Government corporation or independent agency.

The Panama Canal Company is a wholly owned U.S. Government corporation managed by a Board of Directors appointed by the Secretary of the Army. The Canal Zone Government is an independent U.S. Government agency. The budgeting and accounting functions of the Company are subject to the Government Corporation Control Act (31 U.S.C. 841 et seq.) and the government is subject to the Budget and Accounting Act of 1921, as amended.

Under the provisions of the Panama Canal Treaty, the Canal Company and the government would cease to exist. Article III, paragraph 3 of the treaty provides for the establishment of a "... United States Government agency called the Panama Canal Commission, which shall be constituted by and in conformity with the laws of the United States of America."

The Commission would be supervised by a Board composed of five U.S. citizens and four Panamanian nationals. Through December 31, 1989, the Administrator of the Board would be a U.S. citizen and the Deputy Administrator a Panamanian citizen. These roles would reverse on January 1, 1990, and continue until the termination of the treaty at noon, Panamanian time, December 31, 1999.

The implementing legislation has not yet been presented to the Congress but we understand that the administration prefers to stick as closely as possible to the current corporate form. In September, the Secretary of the Army recommended to the Senate Foreign Relations Committee that the future canal organization continue to be operated under the provisions of the Government Corporation Control Act. We believe that this would be appropriate since it would preserve the businesslike accounting and budgeting principles which have successfully served the canal organization for over 25 years.

The distinguishing budgeting, accounting, and auditing features of a Government corporation are: Business-type budgets and maintenance of accounting records in accordance with commercial corporate accounting principles and standards and audit by the General Accounting Office with a mandatory report to Congress.

Information required for the business-type budget includes a statement of financial condition, statement of income and expense, analysis of surplus or deficit and statement of source and application of funds.

Our audit of Government corporations is on a reimbursable basis and is performed in accordance with the principles and procedures applicable to commercial corporate financial transactions. Unless specifically authorized by law, Government corporations cannot engage private accounting firms for audits.

Provision for external audits: A related issue to the type of U.S. Government entity the proposed Commission would take concerns the subject of external audits. The treaty documents do not discuss this issue. Nevertheless, we presume that, unless specifically precluded by law, the General Accounting Office will continue to be responsible for auditing the accounts and operations of the canal organization. It is not clear what role, if any, my counterpart, the Comptroller General of the Republic of Panama, would have under the proposed treaty. However, we believe that it would be appropriate to explore

ways of cooperating with the Comptroller General of Panama concerning the audit.

Transfer of property, U.S. investment and depreciation: I would like now to discuss some of the financial implications of the treaty provisions which would cause major changes in the valuation of U.S. assets, capital-generating depreciation costs, other costs and revenues.

A fundamental economic aspect of the treaty that needs to be addressed by the Congress is the policy question of whether the investment of the United States should be recovered over the life of the treaty. This decision will have a profound effect on the financial operations of the new organization, the toll rates and the taxpayer.

At the time of our last audit for the fiscal year ended June 30, 1975, the United States had an unrecovered investment in the Panama Canal enterprise of \$736 million. According to unaudited figures, this amount increased to \$752 million by the end of fiscal 1977. I should note that these amounts do not include investment in military facilities in the Canal Zone. Under the provisions of the Panama Canal Treaty, the United States will turn over to Panama all its real property, including nonremovable improvements thereon in accordance with a specified timetable, with the final transfer upon expiration of the proposed treaty.

There is currently no systematic method for repaying the invested capital of the Canal Company. The Company repays the invested capital through dividends only when the Board of Directors determines that funds exceeding working capital and capital improvements requirements are available. Since its incorporation, the Company has repaid \$40 million in dividends; the last such payment was in 1969. The invested capital of the Canal Zone Government, however, is being systematically repaid. The cost of operations and capital programs are initially financed by appropriations. The government charges in individuals and other government agencies for services and these revenues are paid into the Treasury. In addition, the difference between these revenues and expenses including depreciation, or the net cost of operations, are paid into the Treasury by the Company. Therefore, the entire costs, including the capital investments, are being recovered.

We have been concerned for some years about the repayment of the U.S. investment in the Canal Company. This concern led us to recommend for many years that certain previously undepreciated assets such as titles, treaty rights and excavations be depreciated and that consideration be given to using the amounts recovered through inclusion of the depreciation of these assets in the toll rate structure for minimal repayments of the U.S. investment. Depreciation on these assets began on July 1, 1973, but the Company's capital requirements have precluded paying any dividends to the Treasury since that time.

The United States could recover its investment by increasing depreciation charges sufficiently above the amounts needed for capital expenditures and raise toll rates to recover this additional depreciation. This would permit repayment of dividends to the Treasury during the lifetime of the treaty. This could be accomplished by adjusting annual depreciation charges to coincide with the provisions of the treaty relating to the transfer of assets.



To recover the existing U.S. investment over the next 22 years would require additional depreciation charges of over \$25 million each year in excess of the new capital investment requirements. While theoretically possible, these actions may not be economically sound because of the impact on toll rates and possible adverse effect on traffic and revenues.

For the proposed Commission to be financially self-sufficient, toll rates would have to be raised to cover these increased depreciation costs. The potential for increasing toll rates and the sensitivity of canal traffic to toll increases is now under study by a private consulting firm, International Research Associates, engaged by the Canal Company. The results of this study are not expected until January 1978. However, based on previous toll studies, it is doubtful that toll rates could be successfully raised to recover both the new payments to Panama and increased depreciation charges designed to recover the past U.S. investment in the canal.

In addition to recovering past U.S. investment in the canal, we are also concerned about the impact of the treaty on future capital outlays. Article XIII of the treaty requires that upon treaty termination the United States turn over the canal "in operating condition and free of liens and debts." This transfer would involve "all real property and nonremovable improvements" used by the United States during the treaty and the "equipment related to the management, operation, and maintenance of the canal."

It is obvious that the United States would have to continue to make some new capital investments during the lifetime of the treaty to meet its treaty obligations and to continue operating the canal in an efficient manner. It is equally obvious that, if the treaty is ratified, new capital budgets should receive close scrutiny by the administration and Congress to assure that only essential capital investments are made.

#### INTEREST PAYMENTS TO THE U.S. TREASURY

Although the Panama Canal Company is not required to systematically repay the U.S. investment in the Company, it is required to pay interest to the Treasury on the interest-bearing U.S. investment which was about \$319 million as of June 30, 1976.

According to Company figures, interest payments due in fiscal year 1976 and the transition quarter were calculated at \$16.7 million and \$4.4 million, totaling \$21.1 million. Interest payments amounted to only \$11.8 million; the difference represents the net operating loss of the Company which must be paid from future revenues. Total interest payments to the Treasury since the establishment of the Company through September 30, 1976, have been about \$272 million.

Although the legislative package for treaty implementation has not yet been presented, we understand that the administration proposes to relieve the Commission of the statutory obligation to pay interest to the Treasury. This proposal would improve the cash position of the new Commission and relieve some of the upward pressure of costs on toll rates, but it would also reduce Treasury receipts and impact on the overall U.S. budget. It will be necessary for the Congress to evaluate this tradeoff when considering implementing legislation.

## TREATY PAYMENTS TO THE REPUBLIC OF PANAMA

Article XIII of the treaty requires the United States to pay \$40 to \$60 million annually to the Republic of Panama for the use of the canal as follows:

Thirty cents per Panama Canal net ton for each tollpaying vessel transiting the canal each year. This rate is indexed to the U.S. Wholesale Price Index for total manufactured goods and would be adjusted biennially, beginning 5 years from the entry into force of the treaty. The current estimated value of this payment is \$40 million annually, a fixed annuity of \$10 million each year; and an annual amount of up to \$10 million per year if canal operating revenues exceed expenditures. If revenues do not produce this surplus in any year, the unpaid balance would be paid from future operating surpluses in a manner to be mutually agreed.

These payments would replace the \$2.3 million annuity currently paid to Panama under the 1955 treaty. The Panama Canal Company pays about \$500,000 of this annuity, and the remaining \$1.8 million is paid through appropriations to the Department of State.

The 30 cents per ton and fixed annuity payments under the proposed treaty appear clear cut. However, a question has been raised whether the additional annual payment to be paid if operating revenues exceed expenditures constitutes a fixed liability of the proposed Commission. If it does, then at termination of the treaty it could require a lump-sum payment of Panama of up to \$220 million if no payments were made during the lifetime of the treaty. On the other hand, if it is a fixed liability, then the Commission could include it as an annual expense in its budget and set toll rates designed to recover this additional expense. We await the implementing legislative package before forming an opinion on this issue.

Mr. METCALFE. May I interrupt you and say there is a rollcall vote on the floor? We would like to recess and pick up your testimony on page 12 when we come back.

We will recess for 15 minutes.

[A brief recess was taken.]

Mr. METCALFE. The recessed meeting of the Subcommittee on the Panama Canal will come to order.

Mr. STAATS, if you can, start where you left off.

Mr. STAATS. Yes, Mr. Chairman.

We were discussing the various payments that would be made under the treaty provisions to the Republic of Panama, and I was at the top of page 12 referring to the last of these payments.

Article III, section 5, of the treaty stipulates another payment to Panama which has raised questions. According to this provision, the Commission would pay the Republic of Panama \$10 million a year for the costs involved in providing the following public services in the canal operating and housing areas: police, fire protection, street maintenance, lighting and cleaning, traffic management, and garbage collection. The treaty is not clear as to whether payments for the first 3 years are a flat \$10 million a year or require a determination of the actual costs incurred by the Republic of Panama. After 3 years, the treaty appears to relate payments to costs. It states: "The costs in-



volved in furnishing said services shall be reexamined to determine whether adjustment of the annual payment should be made because of inflation and other relevant factors affecting the cost of such services."

The treaty documents are silent about how these costs are to be calculated. The treaty also does not contain specific provisions concerning the quality of services to be provided. The implementing agreement for article III of the treaty, however, does provide for the establishment of a United States-Panamanian Coordinating Committee for consultation and coordination on matters concerning the housing areas. On this problem, this committee could possibly serve as a forum for resolution of any problems concerning the quality of public services to be provided by Panama.

It makes a great deal of difference if you are talking about current U.S. costs or if you are talking about different costs which would be future costs for the same services, and you have a third possibility which would be the kind of services which the Panamanian Government should provide for the arrangements. You could get three figures depending upon the concepts adopted.

We believe this is a matter which should be resolved in the implementing legislation because it is a large amount of money.

#### PANAMA'S DEBT FOR PAST SERVICES

As of September 30, 1977, the Republic of Panama owed the canal organization over \$8.4 million for past services. Approximately \$4.8 million of this total was for the operation of Palo Seco hospital, a facility for the treatment of Hansen's disease. The treaty documents provide that the United States continue to provide certain utility services such as power, water, and services in the canal area and that the Commission would be reimbursed for its cost in providing such services. There is no mention in the treaty of Panama's debt for past services. This is an issue which should be resolved either through a lump sum payment to the United States or as a credit against U.S. treaty payments to Panama.

#### BENEFIT PAYMENTS TO CANAL EMPLOYEES

The proposed treaty would have far-reaching effects on the employees of the canal organization, and would require significant additional costs for repatriations, relocations, and early retirements. In September, Governor Parfitt testified before the Senate Foreign Relations Committee that on the effective date of the treaty the work force would be reduced by between 5,000 and 6,000 employees, of which between 2,100 and 2,400 would be transferred to the Department of Defense. An additional reduction of 500 employees would occur by about 30 months later with the phaseout of remaining governmental activities and further reductions would be made throughout the remaining life of the treaty as more Panamanian citizens are employed.

Earlier this month when I was in Panama, Governor Parfitt expressed his concern to me about the morale and fair treatment of the canal labor force. He is concerned both with maintaining an adequate level of services and benefits for all employees, and providing equitable

benefits for those employees who lose their jobs through a reduction in force. One of the proposed benefits is an early optional retirement program for present employees. Another proposal is priority job placement program with other U.S. Government agencies. In addition to new programs, the canal organization has existing obligations to its employees for repatriations and accrued leave.

The details and costs of a reduction in force have not yet been presented. When they are available we can better judge whether the proposed Commission will be able to bear the added expenses or whether appropriations will be necessary.

#### IMPACT OF TREATY ON TOLL RATES

Under existing legislation (2. C.Z.C. sections 62 and 412) the Company is expected to (1) recover all costs of operating and maintaining its facilities, including depreciation ; (2) pay interest to the U.S. Treasury on the U.S. Government's net direct investment in the Company; and (3) reimburse the U.S. Treasury for (a) annuity payments to the Republic of Panama under the convention of 1903, as later modified and (b) the net costs of operating the Canal Zone Government, including depreciation on fixed assets. Tolls are set to recover these costs, not to maximize revenue by charging what the traffic will bear. The proposed treaty is silent on the subject of toll-setting policy, but we presume that the present principle of recovering only costs will continue.

We have not seen the financial picture of a canal organization restructured to the treaty provisions but indications are that an increase in toll rates will be required. It has been estimated that current toll rates would have to be raised between 25 percent and 40 percent to generate sufficient revenues for the estimated \$50 to \$60 million in annual payments to the Republic of Panama as required by the treaty. More precise estimates will require analysis of the financial data which the Canal Company is developing.

As I have indicated, there are a number of financial issues which must be resolved before we know what costs the proposed Commission must cover through tolls. Before toll rates are set, it is also necessary to know the revenue-generating potential. As I mentioned before, International Research Associates is now preparing traffic projections, sensitivity analyses of the impact of various rate increases and estimates of maximum obtainable revenues. We plan to take a close look at this toll study and the Company's financial data. At this time, however, we cannot make an informed statement on the level of future toll rates.

This completes our presentation. We will be happy to respond to any questions you may have.

Mr. METCALFE. Thank you, Mr. Staats.

I take it, it is your feeling that the financing of the Panama Canal operations has worked well over the years and you would like the Canal Commission to follow in the footsteps of this; is that correct?

Mr. STAATS. That is correct.

We think the same pattern and the same concept of corporate accounting should be continued.

Mr. METCALFE. Thank you.



Very succinctly, do you have a position as to whether the assets or liabilities of the Panama Canal Company or Canal Zone Government should be assumed by the Commission?

Mr. STAATS. Do you want to respond to that, Mr. Zappacosta?

Mr. ZAPPACOSTA. Basically, what should be done is a complete inventory taken of the assets that are to be transferred under the treaty provisions. Once the Congress makes a policy determination whether or not the United States is going to recover its investment, then you would either transfer them over at historical costs which are the present costs on the Canal Company's records, or it can be advocated that you transfer them at current value.

However, I believe that we must consider what you are going to gain through a reappraisal of assets. It is almost an accounting nightmare to reappraise the assets to bring them up to current value. This was done in 1951 and took an untold amount of accountants and engineers and what have you to reappraise it.

As far as we can see, a starting point would be to take an inventory of the assets now on the books to make sure that they do, in fact, exist and in what condition they exist.

Mr. METCALFE. Thank you very much.

I would like to thank you, Mr. Staats, Mr. Zappacosta and Mr. Watson for your testimony. Thank you very kindly.

Mr. STAATS. Thank you.

Mr. ZAPPACOSTA. Thank you, Mr. Chairman.

[The following questions and answers were supplied for the record and may be found in appendix A.]

Mr. METCALFE. We will now hear from the Secretary of the Army, the Honorable Clifford Alexander, Jr.

Before proceeding, I would like to ask unanimous consent that any member or any staff member will have the privilege of submitting any questions in the future.

Hearing no objection, that will be the order.

It is now my pleasure to introduce to the subcommittee resourceful leaders of the executive branch, Secretary of the Army, the Honorable Clifford Alexander, Jr., and the Governor of the Canal Zone, General Parfitt.

This is the first opportunity we have had to receive testimony from the Secretary who, as you know, is the distinguished sole stockholder of the Panama Canal Company and supervisor of the Canal Zone Government's affairs.

Mr. Secretary, you have become interested in Panama Canal affairs at a time when we are all at the crossroads. You were not a part of the previous administration, so only recently have we had the benefit of your thinking.

Please proceed as you wish, Mr. Secretary, and Governor Parfitt as well.

#### STATEMENT OF HON. CLIFFORD L. ALEXANDER, JR., SECRETARY OF THE ARMY, AND MAJ. GEN. H. R. PARFITT, GOVERNOR OF THE CANAL ZONE

Secretary ALEXANDER. Mr. Chairman, members of the Panama Canal Subcommittee of the House Committee on Merchant Marine

and Fisheries, I appreciate having this opportunity to appear before you to discuss my views on the economic and financial aspects of the proposed new Panama Canal Treaties and their effects on future canal operations.

Although I serve as head of the Department of the Army, as you have indicated, I have a special responsibility—exclusive of that position—for overseeing the effective and efficient operation of the Panama Canal. As the direct representative of the President on Panama Canal Company and Canal Zone government affairs, I supervise the administration of the Canal Zone government and act as the stockholder of the Panama Canal Company.

While I strongly identify with those who believe that the canal is and will continue to remain a valuable asset in the foreseeable future, I am equally firm in my support for revamping our treaty relationship with Panama.

Through the establishment of a new treaty relationship with Panama, I believe our country has shown that it can establish a sensible and reasonable relationship with a nation that is smaller than ours: through the proposed treaties, we have shown that we can build a cooperative relationship that meets the needs of our fellow human beings, while looking out for our own interests. The proposed treaties would accomplish this end.

They provide our country with an excellent opportunity to do justice to our real accomplishments in Panama, protect the legitimate needs of the United States and international shipping, and rightly take into account the aspirations of the people of Panama. All this can be achieved in a spirit of cooperation and accommodation that has previously been known on few occasions in the history of United States-Latin American relations.

What four administrations—Democrat and Republican alike—have hoped to accomplish is a cooperative partnership with Panama that will foster and enhance the successful canal operation that international shipping has come to expect.

I would like to present a short statement outlining my views of the future operation of the canal. Governor Parfitt will provide additional and more detailed data. After the Governor's presentation, we will be glad to respond to any questions you might have on either the current or proposed operations of the canal.

Over the past 63 years, the Panama Canal organization has provided a valuable service to world shipping: this exceptional service has been recognized by both Members of Congress and by the users of the canal. Under the new treaty, we should continue to operate the canal, utilizing to the greatest extent possible those proven procedures which have been accepted by the Congress and the canal users. Any deviations from proven practices and established managerial procedures should be held to the minimum necessary to conform to the letter and spirit of the treaty. This is highly desirable and certainly achievable under this new treaty.

I would like to briefly address several general aspects of canal operations under the proposed treaties.

Six months after the exchange of ratifications, the Panama Canal Company will be replaced by a successor agency to be known as the Panama Canal Commission.



There are ongoing studies within the administration to determine the most effective relationship of the new Panama Canal Commission to the executive branch of the U.S. Government. While I do not want to prejudge the outcome of those studies, I can present to you some of the organizational considerations that I feel have proven valuable, and will remain important, to the continued success of the canal's operations in the future. They are as follows:

(1) Insure that the organizational arrangement remains compatible with the philosophy that revenue must cover all costs of canal operation and maintenance.

(2) Preserve unity of effort as long as the United States has primary responsibility for operation of the canal. Both authority and responsibility should follow clear direct lines from the Administrator to the President of the United States who retains ultimate responsibility.

(3) Facilitate maximum cooperation between the agency responsible for operating the canal and the military elements which will provide certain support services to that agency, as well as defend the canal and the agency itself, if necessary.

(4) Establish an organizational arrangement that remains compatible with the international utility concept of operation—that the agency exists to serve the shipping interests of all nations.

(5) Insure that the Congress has a continuing role in overseeing the operation of the canal.

(6) I would also like to recommend that the future canal organization continue to operate under the provisions of the Government Corporation Act, thus enabling the canal's operators to utilize business and management practices which will best provide efficient operations at minimum costs to the user.

As in the past, the new Canal Commission will not be dependent on U.S. tax dollars and will continue the longstanding system of self-sufficiency. The Panama Canal Commission will also maintain the same broad mission as the current Panama Canal Company: the movement of ships between the oceans in an effective, efficient, and nondiscriminatory manner.

The Commission will also control the lands and waters necessary to transit ships, and will not be precluded from conducting activities which are directly related to that function; however, the Commission will not perform certain supporting activities now conducted by the Canal Company such as commercial port operations, commercial bunkering, commercial ship repair, and retail sale of goods and services.

Although the existing Panama Canal Company retail stores will be discontinued, U.S. citizen employees of the Commission will be authorized use of military exchanges and commissaries for the first 5 years of the treaty. I have proposed that after that period, additional compensation be provided to these employees to offset associated increases in their cost of living.

How the canal's finances are structured is critically important to the objective of the new treaty—insuring successful canal operations.

There will undoubtedly be an increase in toll rates at the beginning of the treaty to meet necessary increased payments to Panama, and to provide sufficient funds to maintain an effectively operating canal.

The toll increases will also insure that there are adequate revenues available to cover additional costs at the outset of the new United States-Panama relationship.

While Governor Parfitt will discuss in more detail the exact mechanism by which tolls can be increased to meet necessary expenditures, I want to reaffirm that in subsequent years, should the treaty be approved, I would expect the new Panama Canal Commission to hold tolls to the minimum necessary to meet costs. Such a policy will help to insure that the economies of the canal-user nations will not be harmed.

As the President's special designate on canal affairs, I will strive to carry out those practices and principles I have outlined in my statement. I am also prepared to continue serving as the stockholder and Board Chairman of the new Panama Canal Commission should its organization be structured in such a fashion.

While I have made general reference in my statement to particular issues of interest to this committee, I have provided written and more detailed responses to the specific questions your committee has asked me to address. These responses are attached to my formal statement.

I would now like to have Governor Parfitt provide you with some details of the technical aspects I've raised.

[The following was supplied for the record:]

#### QUESTIONS FOR THE SECRETARY OF THE ARMY

1. *Question:* As the Secretary of the Army, designated by the President as the sole stockholder of the Panama Canal Company and supervisor of the Canal Zone Government, what responsibilities do you exercise that relate to the financial affairs of the Panama Canal, and what do you recommend that relationship to the Canal be under the proposed Panama Canal Commission? (Please include the role as Chairman of the Board of Directors in this discussion.)

*Answer:* As stockholder of the Panama Canal Company I appoint the members of the board of directors, making certain that several members have financial and economic expertise. The Boards' primary activity is, of course, to manage the principal affairs of the enterprise. In order to assist the Board in accomplishing its financial oversight responsibilities, a budget and finance committee is appointed. Since I have elected to serve as Chairman of the Board, I possess a single vote on all financial matters brought before the Board, as do other members.

I have designated the Acting Assistant Secretary of the Army (Civil Works) to assist me in carrying out my functions with respect to the Canal Zone Government. He, among his other responsibilities, reviews the finances of the Canal Zone Government, requests studies of various financial issues and, along with the Governor, keeps me informed of budget matters concerning this agency.

Finally, I am responsible for the coordination of personnel policies and activities of the various agencies in the Canal Zone. This includes the authority to establish and change compensation schedules, and to issue regulations controlling the payment of the tropical differential. To assist in this function the Canal Zone Civilian Personnel Policy Coordinating Board has been formed. This Board, chaired by the Acting Assistant Secretary of the Army (Civil Works), consists of the Governor of the Canal Zone and the Commander-in-Chief United States Southern Command.

With respect to the future relationship of the Panama Canal to the United States Government, I would make three basic points. First, the individual or agency that supervises the Canal must retain complete authority along with responsibility for operations of the Canal enterprise. We should not fragment either the authority or responsibility. Second, any plan which is developed must recognize and be compatible with the responsibilities which the Department of Defense will exercise in Panama during the life of the treaty i.e., Defense of the



Canal, operation of schools, hospitals, etc.). Finally, as Secretary of the Army I remain available to continue the Panama Canal functions which I currently perform. I do not seek that responsibility and if a determination is made that other relationships are more suitable, I would support such a plan if Department of the Army military interests are properly protected.

*Question:* Should the U.S. Government have a stockholder or sole stockholder in the Panama Canal Commission?

*Answer:* I would propose that the current United States Government Corporation concept be continued for the Panama Canal Commission and that the President or his representative be designated the stockholder of the Panama Canal Commission.

2. *Question:* What will be the cost of the additional compensation (that you have recommended) for Canal employees in order to make up for the discontinuance of authorization to use military exchange facilities?

*Answer:* The additional cost would be computed based upon the difference between prices which employees are charged at military retail sales facilities in Panama and those that would be charged in Republic of Panama sales outlets for comparable items. It will be necessary to make a comparative analysis shortly before implementation of the cost of living allowance (five years after the effective date of the treaty) in order to establish its exact amount.

*Question:* Will there be any reductions in cost to the Government or Commission that will offset the additional compensation?

*Answer:* Current Panama Canal Company retail operations incur annual losses. The elimination of this deficit would substantially offset the additional funds required to provide a cost of living allowance.

*Question:* Would such compensation be paid by tolls or out of appropriations?

*Answer:* Tolls.

*Question:* Who would be authorized to receive the compensation?

*Answer:* This additional compensation would be authorized to United States citizen employees of the Panama Canal Commission and non-United States citizen employees recruited from outside the Republic of Panama who are in the employment of the Commission at the time Post Exchange, Post Office and commissary privileges are lost.

3. *Question:* Under paragraph 9(a) of Article X of the proposed Treaty "the right of employees to negotiate collective contracts with the Panama Canal Commission is recognized" in accordance with the U.S. forms of collective bargaining. Recognizing the Commission will be a U.S. Government agency, what effect do you believe such a right will have on Canal Commission expenses?

*Answer:* Although negotiated labor agreements are normally expected to be more costly, we would not expect to see a significant increase in expenses if the right to negotiate "collective contracts" under EO 11491 were extended to employees of the Panama Canal Commission. It should be noted, however, that if it were determined that wages were to be negotiable, the cost to the Commission as a result of collective bargaining could be substantially increased.

4. *Question:* How will the proposed Canal treaties and understandings affect the principles for award of damages in connection with accidents in the Canal? Is it anticipated that there will be any change in costs to the Canal enterprise for any changes made?

*Answer:* In the case of vessel accidents occurring anywhere in Canal Zone waters outside the Canal locks, the Commission would be required to pay damages on all non-contractual claims for injuries caused by the negligence of Commission employees in the performance of official duties. This is the same standard to which the Panama Canal Company is presently held in such cases. As for vessel accidents occurring in the Canal locks, under current law, the Company is a virtual insurer and such condition would generally continue under the new treaty.

The loss of jurisdiction of the U.S. District Court in the Canal Zone over civil cases would mean that vessel accident claims against the Commission would have to be tried in the United States. While that situation might result in increased costs (for transporting witnesses back and forth, etc.), such expenditures could be limited by legislation vesting jurisdiction over such cases in a district in the southern United States, and adopting a statute of limitations governing vessel accident suits against the Commission patterned after that contained in the Federal Tort Claims Act. The latter measure would serve to increase significantly the number of claims which could be settled without suit being filed.

5. *Question:* What changes in special forms of employee compensation do you recommend under the proposed treaty package, and what financial impact would these recommendations have on the financing of the Commission and the obligations of the United States Government?

*Answer:* Special compensation paid to Commission employees in the future should be sufficient to provide an adequate retention and recruitment incentive. This incentive could be made available in a number of ways, including the payment of a tropical differential, a foreign area cost of living allowance, etc. The Commission should be authorized to develop incentives in the forms and amounts necessary to insure the recruitment and retention of those critical skills not available in Panama.

It is virtually impossible to determine the exact amount of special compensation which would be required as an employment incentive. It should, however, be held to the minimum necessary to accomplish the desired recruitment and retention objectives. I would hope that we could retain the current working and living conditions and that additional special compensation would only be required to offset the loss of certain service facilities.

**Governor PARFITT.** Mr. Chairman and members of the committee, you have asked that I address the financial and economic ramifications of the proposed Panama Canal Treaties, and I am pleased to do so. I am sure that you can appreciate—given the complexity of the canal organization—that it is an enormous task to quantify the impact of the treaty on operations. To this end, we are conducting a major study throughout all levels of management to determine the form the new organization should take and the costs associated with it. At the same time, in conjunction with the State Department, we are having an economic study performed to forecast potential canal traffic and to determine the impact on canal traffic of various toll rate increases that may be necessary under the new treaties. Since the two studies will not be available until early next year, the figures on which we base our analysis and conclusions today are tentative and subject to later modification.

I have appended to my statement for the record answers to the specific questions contained in your letter of invitation. My oral testimony will respond more generally to the broad issues involved.

First, however, I would like to outline key elements of the current financial and economic situation which may be helpful in assessing treaty impacts.

#### CURRENT SITUATION

The present financial structure of the Panama Canal Company and Canal Zone Government dates back to the Panama Canal Reorganization Act of 1950, which became effective at the start of fiscal year 1952. The Company has a corporate structure and maintains business-type accounts. Budgets are submitted for review and approval by the Office of Management and Budget, and the Congress, and our accounts are audited by the General Accounting Office.

In contrast, the Canal Zone Government operates under what you might call "normal" Government accounting procedures. Appropriations are requested and obtained annually to cover both operations and capital programs. Operating appropriations are repaid to the U.S. Treasury during the course of the year, through revenues and by the Company as the net cost of operation of the Canal Zone Government. Capital appropriations are paid back to the Treasury over the life of the assets.



The underlying principle of the Company's statutory financial plan is that the canal enterprise will operate on a self-sufficient basis. To this end, Company costs are prescribed to include normal costs of operation and maintenance, interest on the net direct investment of the United States, a portion of the annuity to Panama, and the net cost of operation of the Canal Zone Government.

Undergirding this plan are several important and farsighted measures that were included in the Reorganization Act of 1950, as amended, to provide for cash in time of extraordinary need. These measures provide authority for the Company to:

(a) Borrow up to \$40,000,000 from the U.S. Treasury (interest would be paid).

(b) Obtain appropriations to cover losses (no interest would be paid).

(c) Obtain appropriations for capital needs (no interest would be paid).

(d) Defer payment to the Treasury for interest on the net direct investment, for the net operating cost of the Canal Zone Government, and for the Company's share of the annuity to Panama to the extent that earnings are inadequate to make such payments. (No interest would be paid, but repayments are required to be made from subsequent earnings.)

The system has worked well. The Canal Company has been self-sustaining and operated at no cost to the U.S. taxpayer. Since 1952, it has repaid \$40 million of the U.S. investment and has financed \$315 million of capital replacements and improvements from internally generated funds and, in addition, has paid \$269 million in interest to the U.S. Treasury on the net direct investment.

This has not been accomplished without problems, however. As anticipated, there have been some years when the canal operation has not been able to produce revenues sufficient to cover all of its costs. Such was the case in the period fiscal year 1973 through the fiscal year 1976 transition quarter, when we experienced high inflationary costs along with a sharp reduction in traffic resulting from termination of the Vietnam war, a worldwide recession, and the reopening of the Suez Canal. During this period, the Company's losses totaled \$30.6 million.

Unfortunately, there are factors which limit our ability to cut costs in response to such a decline in workload. Of the Company's total costs, approximately two-thirds are fixed; only one-third are variable, that is, costs that can be associated with the transit of individual ships. For this reason, we cannot necessarily cut our costs 10 percent to respond to a 10-percent drop in the workload. Thus, the response to a reduction in transits from a high of over 38 oceangoing commercial ships a day to less than 33 a day had to be more than a corollary reduction in directly related costs. It required an extensive austerity program in all areas of the Company and government, an increase in rates for all services rendered, and two toll increases. As a result of all these measures, we were able to turn the financial results around, and for fiscal year 1977 we realized an unaudited net margin of \$5.4 million. The losses in fiscal year 1973 through fiscal year 1975 were absorbed by the Company, and its cash resources were diminished to that extent.

However, in fiscal year 1976 and the transition quarter, it was necessary to take advantage of the authority to defer payment of unearned costs, in order not to draw down cash resources further. The total unearned costs for the period amounted to \$9.3 million. In keeping with the requirement to repay this amount to the Treasury in subsequent years, the last tolls increase included provision for repayment of this amount over a 3-year period. The earnings of \$5.4 million in fiscal year 1977 will be applied to this debt, and it now seems likely that the balance, \$3.9 million, can be paid in fiscal year 1978. This procedure—part of the organization's underlying financial structure—permitted the Company to protect its cash flow—and thereby its important capital program.

Transits are still down from prior years but commercial cargo has begun to pick up again. Traffic is expected to grow, but at a moderate rate. Thus, even without taking into account the impact of the new treaties, periodic increases in tolls may be necessary to absorb the increase in costs resulting from inflation. In the short run, North Slope oil movements through the canal could temporarily alter our growth pattern and need for tolls increases.

This is the situation against which treaty changes must be scrutinized. Before doing so, however, I will briefly outline the broad financial aspects of the treaty.

#### FINANCIAL ASPECTS OF THE TREATY

Almost every aspect of the treaty and its implementing agreement has its financial impact. Some provisions will result in cost savings, while others will add costs. I will cover here only those provisions which appear to have major significance. They generally fall into the following categories: Reduction in areas; facilities and functions; employee provisions; and direct payments to Panama.

#### REDUCTION IN AREAS

The land and water areas designated by the treaty for use of the Panama Canal Commission represent about 42 percent of areas now available to the Company/Government. They fall into four categories: The canal operating areas, consisting of a continuous area generally following the Panama Canal and generally contiguous to it plus certain additional noncontiguous areas; certain accessory installations and facilities outside the areas made available for the use of the United States, anchorages; and housing areas for U.S. citizens.

The housing areas are to be administered in accordance with rules set out in the implementing agreement. Title to the housing will pass to Panama with the Commission having rights, without cost, to use, manage, maintain, improve and rent such housing. Houses not required for U.S. citizen employees will pass exclusively to Panama in accordance with a prescribed schedule.

#### REDUCTION IN FACILITIES

As of June 1977, the net book value of property, plant and equipment of the Company/Government was \$567.3 million. On the effective



date of the treaty, an estimated \$92 million of these assets will be transferred to Panama and \$30 million to DOD agencies. An additional \$3.8 million in assets will be transferred to Panama during early phases of the treaty with the residual assets becoming the property of Panama upon termination of the treaty. Property acquired by the Commission during the life of the treaty would also go to Panama at the conclusion of the treaty. Very rough estimates would indicate that these could amount in current dollars to an average of \$25 million to \$30 million per year over the life of the treaty.

#### REDUCTION IN FUNCTIONS

Regarding functions, the proposed Commission would have no authority to perform most governmental and commercial functions. The majority of these functions would be performed after the effective date of the treaty by the Panamanian Government or by private interests in Panama. These include: The operation of the ports of Balboa and Cristobal, including stevedoring and bunkering; the operation of the railroad, retail operations; licensing of vehicles, vessels and aircraft; partial provision of police and fire protection; operation of certain recreational and amusement facilities; and provision of customs and immigration services. The provision of postal, food and retail store services (available initially to U.S. citizen employees from the U.S. military), the total police function, and the operation of the prison and court system will likewise be provided by Panamanian sources after prescribed phaseout periods. Other functions—the operation of schools and hospitals—will be transferred immediately to another U.S. Government agency, probably the Department of Defense.

#### EMPLOYEE PROVISIONS

The treaties make specific reference to several matters relating directly to present personnel. Pertinent provisions include commitments:

(1) To provide employment conditions, for Company/Government employees who remain with the Commission, generally no less favorable than those prevailing prior to the treaty.

(2) To recognize the right of Commission employees to negotiate collective contracts.

(3) To establish a policy for periodic rotation, at a maximum of every five years, of any new non-Panamanian employees.

(4) To expand training programs for Panamanian employees.

Under the treaty, the Commission will also have the authority, and presumably the need, to pay additional remuneration of benefits to employees recruited from outside of the Republic of Panama.

The foregoing discussion does not take into account treaty-related costs to be borne by other U.S. agencies, the most significant of which is the effect on the civil service retirement fund of the treaty commitment to provide an appropriate early optional retirement program for canal workers.

#### PAYMENTS TO PANAMA

With respect to direct payments, Panama is to receive the following out of canal operating revenues:

(1) Thirty cents per Panama Canal net ton of shipping transiting the canal, adjusted biennially to reflect changes in the U.S. Wholesale Price Index for total manufactured goods, with the first adjustment taking place after 5 years.

(2) A fixed annuity of \$10 million.

(3) An additional \$10 million per year to the extent that revenues exceed expenditures. In the event revenues in any year do not produce a surplus sufficient to cover this payment, the unpaid balance is to be paid from operating surpluses in future years.

(4) \$10 million per year for certain specified public services to be provided in canal operating areas and housing areas.

These treaty provisions will impose a significant additional financial burden on the Commission which the present Company does not have. They will also have an effect on the ability of the Commission to weather adverse conditions without outside help. In this regard, our tentative assessment reflects the following.

#### INCREASED FINANCIAL BURDEN

The net financial impact of the treaty provisions on the Commission's operations can be roughly determined by calculating the effect the provisions would have had on the actual financial results for fiscal year 1977 and those projected in the fiscal year 1978 budget. Such calculations have been made with the conclusion that, without considering North Slope oil movements, there would be a net deficiency in toll revenues of approximately \$50 to \$60 million. This excludes the existing requirement to pay interest on the net direct investment of the United States in the canal (\$18.1 million in fiscal year 1977) and the \$10 million to be paid to Panama if revenues exceed expenditures.

Using tolls sensitivity curves developed in 1974, a tolls increase of approximately 40 percent would be required to offset this deficiency. However, North Slope oil is now moving through the canal in quantities which would generate \$10 million on an annualized basis. An increase of such revenues to \$25 million annually, which is possible within the next few years, would reduce the requirement to raise tolls from 40 percent to about 25 percent, at least temporarily.

We consider this to be only a general indicator. Results were obtained from a preliminary analysis, and reliability is dependent on the accuracy of the assumptions. For example, although it was relatively simple to identify costs reduced and revenues lost as a result of a reduction in areas and facilities, and the elimination of many functions, it was much more difficult to estimate the cost of services to be provided by others. Furthermore, secondary effects need to be more carefully analyzed—transition costs of severance pay, repatriation, and plant relocations need to be reverified; and updated traffic projections and sensitivity of traffic to varying tolls increases must be obtained. These are the subjects of our very detailed review of the financial implications of the treaty which will be completed in January.

At this point, I should note that the problem is more complex than merely determining how much tolls must be increased initially. It is also important to view the problem for the total life of the treaty.



After the initial years, transition costs should drop out; however, other costs will continue to rise with inflation, including most of the required direct payments to Panama. Here, too, our ongoing studies will attempt to identify and quantify potential problem areas and their long-term effect.

#### OTHER FINANCIAL IMPACTS

Other potential financial problems may stem from the requirement for the contingent \$10 million payment to Panama, difficulties in providing adequate capital funds, and the inability of the Commission to defer payments to the U.S. Treasury as a result of the elimination of the payments for the net cost of the Canal Zone Government, the company's portion of the present annuity to Panama, and the interest on the net direct investment.

I understand that the administration intends to propose that the contingent \$10 million to be paid to Panama will be paid only after the operating revenues of a given fiscal period are first reduced by all expenditures of that period including amounts paid or payable for operation and maintenance, inventory, plant, goods, services, and that portion of the unfunded liabilities paid or currently payable, including the payments to Panama under paragraphs 4(a) and 4(b) of article XIII, and under paragraph 5 of article III of the treaty, as well as the cumulative sum from prior years of any excess of expenditures over operating revenues, as defined above, and the carryover of funds acquired under a tolls formula for plant but not expended within the period.

It is entirely possible that we may be able to overcome these other financial problems through legislation to implement the treaty. We are seeking ways to accomplish this end. As previously indicated, one possibility is to obtain authorization for inclusion in the tolls base of capital requirements in excess of depreciation, with the requirement that funds so generated be reserved for such purpose.

Further, there is the possibility of going to some form of current value accounting, revaluing the assets to give them a depreciable value more closely related to their replacement cost. We are still fleshing out these ideas and exploring others which hopefully will add to the financial stability and viability of the Commission under the new treaty.

#### SUMMARY

In summary, I have attempted to outline briefly the current financial situation of the canal enterprise, and to identify and measure the treaty provisions most likely to have a significant financial impact on the successor agency. The financial record of the current organization over a prolonged period and under diverse circumstances is impressive. Thus, we face the future with optimism, notwithstanding the inherent challenge in a situation where we foresee a very modest growth rate in canal traffic and tolls revenues.

The treaty, if ratified, will open up a new era in the financial operations of the canal organization. The structure of the organization will be changed, the nature of costs will be changed, and many of the ground rules under which we operate may be changed. The net finan-

cial burden of treaty provisions will be significant and will impact immediately, with cumulative and increased effects over time. Quantification of these effects to date are imprecise and incomplete.

The studies underway should provide us with more complete and reliable findings and recommendations in these areas. I am hopeful that, using the strengths of the present financial structure as a guide, we can provide a solution to the problems identified. The canal has been a model of operating efficiency and financial stability since it was built, and we will bend every effort to the end that it continues to be both.

In conclusion, I hope that the information I have submitted, in spite of its limitations, will serve to advance your understanding. We plan to have far more complete answers for you in the near future. In the meantime, should you desire additional data concerning my testimony, I will be pleased to furnish them.

[The following are questions posed to the witness by the subcommittee, with the responses received prior to the hearing:]

#### ANSWERS TO QUESTIONS FROM SUBCOMMITTEE (INCLUDES SUPPLEMENTARY QUESTIONS)

##### TRANSFER OF ASSETS

*Question 1.* Estimate at least the approximate value of real and personal property and assets to be transferred to Panama (a) upon the entry into force of the treaty; (b) the value of all property and assets to be transferred subsequent to the entry into force of the treaty and before the termination of the treaty; and (c) the value of all property and assets that must be transferred by the termination of the treaty. Explain this by charts and graphs, if possible.

Answer. The following table summarizes, by the requested time periods, the estimated plant values of the properties which will be transferred to the Republic of Panama in accordance with the provisions of the treaties. These estimates are based on the original cost and net book values recorded in Panama Canal books at June 30, 1977. Not included in these totals are minor items of equipment costing less than \$1,000.

[In millions]

	Original cost	Transferred net book value
Early treaty:		
Upon the entry into force of the treaties <sup>1</sup> .....	\$185	<sup>2</sup> \$92
Subsequent to entry into force of the treaties and before the termination of the treaties. ....	9	<sup>2</sup> 4
Subtotal .....	194	96
Upon termination of the treaties:		
Existing assets <sup>3</sup> .....	788	<sup>4</sup> 98
Estimated value of capital improvements to be made during life of treaty .....	616	<sup>4</sup> 454
Subtotal .....	1,404	552
Total <sup>5</sup> .....	1,598	648

<sup>1</sup> This includes U.S. community housing (original cost and net book value of \$44,600,000 and \$26,400,000, respectively), the use of which will be granted by Panama to the Commission to house U.S. citizen employees. These houses will be relinquished to Panama over the life of the treaty in accordance with a prescribed schedule.

<sup>2</sup> This is the net book value at June 30, 1977.

<sup>3</sup> Included in these totals are the estimated values of properties (original cost and net book value of \$47,000,000 and \$30,000,000, respectively) that will be transferred to other U.S. Government agencies during the life of the treaties and in turn will be transferred by them to the Republic of Panama upon termination of the treaties. These are principally school and health facilities.

<sup>4</sup> For purposes of estimating book value of facilities to be transferred upon treaty termination, an estimated composite depreciation rate has been calculated and applied on a straight line basis to the original cost values to approximate current Panama Canal accounting practices.

<sup>5</sup> Included in these totals are certain items of removable property and equipment, with an estimated net book value of \$2,000,000, which the Commission has the option, under the treaty, of disposing of by other than transfer to Panama.



*Question 2.* If the Panama Canal Treaty is ratified, the present Canal organization will have to dispose of the assets and property associated with activities that are not to be continued by the Commission. Paragraph 4 of the Annex to the Panama Canal Treaty lists these activities.

What is the approximate value of the assets to be disposed of in reference to those activities; how would such disposal take place; and how would the proceeds of the disposal be applied toward the balance sheet of the present Canal organization or the proposed Commission?

Answer. I infer from this question that you are interested in the total estimated value of the properties the Panama Canal enterprise will be required to dispose of as a result of Treaty provisions that prohibit the enterprise from continuing certain activities, including those activities which are not enumerated in paragraph 4 of the Annex to the Panama Canal Treaty, such as the railroad and marine bunkering activities. On this basis the total estimated original cost and net book value of the properties the Panama Canal enterprise will be required to dispose of during the life of the treaties is estimated to be \$240 and \$126 million, respectively. These estimates are based on the original cost and net book values recorded in the Panama Canal Company books at June 30, 1977. Included in these amounts are the estimated value of properties that will be transferred to other U.S. Government agencies totaling \$47 and \$30 million for the original cost and net book value, respectively.

These properties would be disposed of following the present accounting and operating procedures for disposing of excess properties. The net book value of these assets will be written off against the United States' investment in the Panama Canal Company and against the United States' equity in the Canal Zone Government based on the Agency which holds title to the disposed of property.

The majority of these assets will be transferred to the Republic of Panama and to other United States Government agencies without the exchange of funds. However, removable property and equipment with a net book value of approximately \$2 million may be disposed of with proceeds accumulating to the benefit of the Commission. Materials and supplies on hand and no longer required will be handled in a similar manner.

*Question 3(a).* In what manner will the treaties affect the cost of operation of the Panama Canal?

Answer. The overall effect of the changes to be imposed by the treaties will be to increase the net cost of operation of the Panama Canal.

At this point in time, only very rough order-of-magnitude estimates are available on the net financial impact of the treaties on Canal operating costs. These estimates indicate probable higher net costs, ranging from \$50 to \$60 million during the first year. A study is under way to determine more definitely the effect of the treaties on the cost structure of the Canal. The Subcommittee will be furnished the results of this study upon its completion, which is expected to be in late January.

EFFECT ON MARGIN OF 19.5 PERCENT TOLL INCREASE, 1979-81

	1979	1980	1981
Total costs recoverable from tolls.....	\$231, 657	\$235, 015	\$238, 374
Tolls revenues at existing rates.....	194, 943	198, 385	200, 127
Net deficiency.....	36, 714	36, 630	38, 247
Impact of 19.5 percent toll increase:			
Additional revenues.....	36, 918	36, 915	36, 975
Reduced annuity to Panama based on PC net tons.....	215	343	397
Net income or deficiency.....	419	628	(875)

## STATEMENT OF OPERATIONS UNDER THE 1977 TREATY, FISCAL YEAR 1979-84

[In thousands of dollars]

	President's budget 1979	Estimates with treaty-imposed changes					
		1979	1980	1981	1982	1983	1984
<b>Operating expenses:</b>							
Maintenance of channels and harbors.....	25,578	25,528	25,563	25,568	25,568	25,568	25,568
Navigation service and control.....	45,643	42,932	42,887	42,797	42,641	42,641	42,641
Locks operation.....	27,187	27,187	27,187	27,187	27,187	27,187	27,187
General repair, storehouse, engineering and maintenance service.....	8,107	6,357	5,992	5,739	5,536	5,536	5,536
Marine terminals.....	22,868	76					
Transportation and utilities.....	22,986	27,262	27,629	27,358	27,659	27,684	27,426
Retail and housing.....	53,549	5,184	5,184	5,184	5,184	5,184	5,184
General and administrative.....	55,448	47,763	47,564	45,146	43,615	43,502	47,689
Interest.....	20,058						
Governmental activities.....	90,976	22,271	21,310	16,790	13,377	13,366	13,331
Other.....	18,596	15,230	15,255	15,255	15,255	15,255	15,255
<b>Total operating expense.....</b>	<b>390,996</b>	<b>219,800</b>	<b>218,571</b>	<b>211,024</b>	<b>206,022</b>	<b>205,923</b>	<b>209,817</b>
<b>Operating revenues:</b>							
Navigation service and control.....	30,975	27,209	27,209	27,209	27,209	27,209	27,209
General repair, storehouse, engineering, and maintenance service.....	5,500	1,127	1,065	784	484	484	484
Marine terminals.....	28,213						
Transportation and utilities.....	24,884	26,737	26,656	26,687	26,659	26,651	25,891
Retail and housing.....	47,284	4,850	4,850	4,850	4,850	4,850	4,850
Governmental activities.....	66,122	2,648	2,648	2,595	2,595	2,595	2,595
Other.....	2,365	678	2,165	665	665	2,165	665
<b>Total revenues and recoveries other than tolls.....</b>	<b>205,343</b>	<b>63,249</b>	<b>64,593</b>	<b>62,790</b>	<b>62,462</b>	<b>63,954</b>	<b>61,694</b>
<b>Net operating expenses exclusive of pay- ments to Panama and transition costs....</b>	<b>185,653</b>	<b>156,551</b>	<b>153,978</b>	<b>148,234</b>	<b>143,560</b>	<b>141,969</b>	<b>148,123</b>
<b>Payments to Panama:</b>							
Fixed annuity to Panama.....	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Public services payment to Panama.....	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Annuity to Panama based on PCC net tons.....	46,786	47,612	48,031	48,673	49,315	49,958	49,958
<b>Total payments to Panama.....</b>	<b>66,786</b>	<b>67,612</b>	<b>68,031</b>	<b>68,673</b>	<b>69,315</b>	<b>69,958</b>	<b>69,958</b>
<b>Net operating expenses including pay- ments to Panama.....</b>	<b>185,653</b>	<b>223,337</b>	<b>221,590</b>	<b>216,265</b>	<b>212,233</b>	<b>211,284</b>	<b>218,081</b>
<b>Net operating expenses including payments to Panama.....</b>	<b>223,337</b>	<b>221,590</b>	<b>216,265</b>	<b>212,233</b>	<b>211,284</b>	<b>218,081</b>	<b>218,081</b>
<b>Transition costs:</b>							
Severance pay.....	4,271	174	733				
Repatriation.....	1,909	287	1,099	192			
Plant relocations.....	931	2,999	3,053	2,313			
Inventory moves and storage.....	665						
<b>Total operating expenses to be recovered from tolls.....</b>	<b>231,113</b>	<b>225,050</b>	<b>221,150</b>	<b>214,738</b>	<b>211,284</b>	<b>218,081</b>	<b>218,081</b>
<b>Capital program requirements in excess of depreciation.....</b>	<b>544</b>	<b>1,993</b>	<b>1,377</b>	<b>1,099</b>	<b>2,237</b>	<b>2,336</b>	<b>2,336</b>
<b>Total costs recoverable from tolls before inflation.....</b>	<b>231,657</b>	<b>227,043</b>	<b>222,527</b>	<b>215,837</b>	<b>213,521</b>	<b>220,417</b>	<b>220,417</b>
<b>Provision for inflation at 5 percent:</b>							
Annuity to Panama based on PC net tons.....							5,121
All other costs.....		7,972	15,836	23,197	31,077		41,569
<b>Total costs recoverable from tolls.....</b>	<b>231,657</b>	<b>235,015</b>	<b>238,363</b>	<b>239,034</b>	<b>244,598</b>	<b>267,107</b>	<b>267,107</b>
<b>Tolls income at existing rates.....</b>	<b>194,943</b>	<b>198,385</b>	<b>200,127</b>	<b>202,803</b>	<b>205,480</b>	<b>208,157</b>	<b>208,157</b>
<b>Net deficiency.....</b>	<b>36,714</b>	<b>36,630</b>	<b>38,236</b>	<b>36,231</b>	<b>39,118</b>	<b>58,950</b>	<b>58,950</b>

Note: The impact in 1978 of treaty-related requirements are as follows: Capital expenditures for relocations, \$1,900,000; cost increases, including relocations classified as expense, \$2,300,000; revenue losses, \$900,000; a total of \$5,000,000. There is an estimated potential loss of \$2,000,000 on retail inventories. In addition, there is \$1,200,000 of operating supplies and materials inventories related to those facilities to be transferred to Panama and other U.S. Government agencies, the value of which may not be fully recoverable.



## DETAILED STATEMENT OF OPERATING COSTS AND REVENUES

(In thousands of dollars)

	President's budget 1979	Estimates with treaty-imposed changes					
	1979	1980	1981	1982	1983	1984	
OPERATING EXPENSES							
Maintenance of channels and harbors:							
Funded costs.....	23,961	23,933	22,288	22,263	22,263	22,263	
Nonfund expense.....	9,479	9,457	9,537	9,567	9,567	9,567	
Cost transfer.....	(7,862)	(7,862)	(6,262)	(6,262)	(6,262)	(6,262)	
Net expense.....	25,578	25,528	25,563	25,568	25,568	25,568	
Navigation service and control:							
Funded costs.....	44,777	42,117	42,043	41,993	41,993	41,993	
Nonfund expense.....	1,032	991	1,010	970	814	814	
Cost transfer.....	(166)	(166)	(166)	(166)	(166)	(166)	
Net expense.....	45,643	42,942	42,887	42,797	42,641	42,641	
Locks operations:							
Funded costs.....	24,643	24,643	24,643	24,643	24,643	24,643	
Nonfund expense.....	4,133	4,133	4,133	4,133	4,133	4,133	
Cost transfer.....	(1,589)	(1,589)	(1,589)	(1,589)	(1,589)	(1,589)	
Net expense.....	27,187	27,187	27,187	27,187	27,187	27,187	
General repair, storehouse, engineering and maintenance services:							
Storehouse direct expense.....	4,402	3,884	4,004	3,941	3,941	3,941	
Cost of goods sold.....	2,431						
Cost of goods issued.....	15,706	11,266	10,266	9,326	9,326	9,326	
Nonfund expense.....	91	90	91	91	91	91	
Cost transfer.....	(16,353)	(11,206)	(10,578)	(9,638)	(9,638)	(9,638)	
Net expense.....	6,277	4,034	3,783	3,720	3,720	3,720	
General services direct expense.....	17,135	9,348	9,348	9,348	9,348	9,348	
Nonfund expense.....	168	168	168	168	168	168	
Cost transfer.....	(16,879)	(9,456)	(9,456)	(9,456)	(9,456)	(9,456)	
Net expense.....	424	60	60	60	60	60	
Vessel repair direct expense.....	13,160	12,447	12,050	12,050	12,050	12,050	
Nonfund expense.....	230	215	215	215	215	215	
Cost transfer.....	(12,604)	(11,553)	(11,250)	(11,250)	(11,250)	(11,250)	
Net expense.....	786	1,109	1,015	1,015	1,015	1,015	
Electrical service direct expense.....	5,214	4,593	4,593	4,489	4,320	4,320	
Nonfund expense.....	14	14	14	14	14	14	
Cost transfer.....	(5,248)	(4,201)	(4,201)	(4,251)	(4,230)	(4,230)	
Net expense.....	(20)	406	406	252	104	104	
Engineering service direct expense.....	3,614	3,449	3,399	3,207	3,047	3,047	
Nonfund expense.....	123	123	123	123	123	123	
Cost transfer.....	(3,456)	(3,180)	(3,150)	(2,994)	(2,889)	(2,889)	
Net expense.....	281	392	372	336	281	281	
Contract and inspection direct expense.....	897	902	902	885	868	868	
Nonfund expense.....	6	6	6	6	6	6	
Cost transfer.....	(890)	(898)	(898)	(881)	(864)	(864)	
Net expense.....	13	10	10	10	10	10	
General laboratory direct expense.....	340	340	340	340	340	340	
Nonfund expense.....	6	6	6	6	6	6	
Cost transfer.....							
Net expense.....	346	346	346	346	346	346	
Total, general repair, storehouse, en- gineering and maintenance service expense.....	8,107	6,357	5,992	5,739	5,536	5,536	

## DETAILED STATEMENT OF OPERATING COSTS AND REVENUES—Continued

[In thousands of dollars]

	President's budget 1979	Estimates with treaty-imposed changes					
		1979	1980	1981	1982	1983	1984
OPERATING EXPENSES—Continued							
Marine terminals:							
Harbor terminals direct expense.....	18,927	76					
Nonfund expense.....	590						
Cost transfer.....	(1,622)						
Net expense.....	17,895	76					
Marine bunkering direct expense.....	4,905						
Nonfund expense.....	311						
Cost transfer.....	(243)						
Net expense.....	4,973						
Total, marine terminals expense.....	22,868	76					
Transportation and utilities:							
Railroad direct expense.....	3,722						
Nonfund expense.....	158						
Cost transfer.....	(1,277)						
Net expense.....	2,603						
Motor transportation direct expense.....	8,421	7,150	7,150	7,150	7,107	7,107	7,107
Nonfund expense.....	767	641	641	641	636	636	636
Cost transfer.....	(8,814)	(7,791)	(7,791)	(7,791)	(7,743)	(7,743)	(7,743)
Net expense.....	374						
Water transportation direct expense.....	10,261	12,472	12,193	11,565	11,771	11,717	11,450
Nonfund expense.....	56	56	56	56	56	56	56
Cost transfer.....	(6,777)	(4,507)	(3,816)	(3,461)	(3,360)	(3,281)	(3,272)
Net expense.....	3,540	8,021	8,433	8,160	8,467	8,492	8,234
Power system direct expense.....	18,100	18,010	18,010	18,010	18,010	18,010	18,010
Nonfund expense.....	1,402	1,402	1,402	1,402	1,402	1,402	1,402
Cost transfer.....	(7,816)	(5,650)	(5,650)	(5,599)	(5,599)	(5,599)	(5,599)
Net expense.....	11,686	13,762	13,762	13,813	13,813	13,813	13,813
Communications system direct expense.....	3,800	3,509	3,242	3,120	3,034	3,034	3,034
Nonfund expense.....	487	487	515	544	576	576	576
Cost transfer.....	(3,377)	(3,127)	(2,933)	(2,889)	(2,845)	(2,845)	(2,845)
Net expense.....	910	869	824	775	765	765	765
Water system direct expense.....	4,028	4,043	4,043	4,043	4,043	4,043	4,043
Nonfund expense.....	374	371	371	371	371	371	371
Cost transfer.....	(590)	(448)	(448)	(448)	(444)	(444)	(444)
Net expense.....	3,812	3,966	3,966	3,966	3,970	3,970	3,970
Central air-conditioning direct expense.....	809	809	809	809	809	809	809
Nonfund expense.....	89	89	89	89	89	89	89
Cost transfer.....	(837)	(254)	(254)	(254)	(254)	(254)	(254)
Net expense.....	61	644	644	644	644	644	644
Total, transportation and utilities expense.....	22,986	27,262	27,629	27,358	27,659	27,684	27,426
Retail and housing:							
Retail units direct expense.....	17,821						
Nonfund expense.....	273						
Cost of goods sold and issued.....	27,965						
Cost transfer.....	(4,257)						
Net expense.....	41,802						
Food units direct expense.....	2,891						
Nonfund expense.....	87						
Cost of goods sold and issued.....	2,110						
Cost transfer.....	(576)						
Net expense.....	4,512						



## DETAILED STATEMENT OF OPERATING COSTS AND REVENUES—Continued

(In thousands of dollars)

	Presi- dent's budget 1979	Estimates with treaty-imposed changes					
		1979	1980	1981	1982	1983	1984
OPERATING EXPENSES—Continued							
Theaters and bowling alleys direct expense.....	668						
Nonfund expense.....	34						
Cost transfer.....	(14)						
Net expense.....	688						
Employee housing:							
ABC housing direct expense.....	4,367	4,505	4,505	4,505	4,505	4,505	4,505
DEF housing direct expense.....	1,357						
Nonfund, ABC.....	822	800	800	800	800	800	800
Nonfund, DEF.....	127						
Cost transfer.....	(126)	(121)	(121)	(121)	(121)	(121)	(121)
Net expense.....	6,547	5,184	5,184	5,184	5,184	5,184	5,184
Total, retail and housing expense.....	53,549	5,184	5,184	5,184	5,184	5,184	5,184
General and administrative expense:							
Under statutory limitation:							
Executive direction.....	3,777	4,060	4,064	4,007	3,922	3,922	3,922
Operation direction.....	2,418	2,005	2,018	1,928	1,941	1,941	1,941
Financial management.....	9,161	9,103	8,923	8,656	8,519	8,519	8,519
Personnel administration.....	3,208	3,222	3,065	3,065	3,065	3,065	3,065
General services.....	3,516	4,121	4,015	3,947	3,936	3,936	3,935
Employment costs:							
Recruit and repatriation.....	1,253	550	550	550	550	550	550
Employee States travel.....	1,482	1,300	1,290	1,233	1,225	1,225	1,225
Transport of employee's vehicles.....	273	239	238	227	226	226	226
Apprentice program.....	1,345	1,484	1,862	2,046	2,046	2,046	2,046
Employer's cost for FEGLI.....	750	520	520	510	510	510	510
Employer's cost for FICA.....	155	83	82	99	120	120	120
Incentive awards.....	242	162	162	162	162	162	162
Subtotal.....	27,580	26,849	26,789	26,430	26,222	26,222	26,222
Other general corporate expense:							
Cost of living allowance.....							4,500
Sponsorship for education.....	7,213	7,144	7,159	6,424	6,218	6,105	5,992
Sponsorship for health services.....	4,132	2,943	2,914	1,751	689	689	689
Sponsorship for fire protection.....	2,571						
Employer's cost for health benefits.....	6,551	4,527	4,522	4,462	4,459	4,459	4,459
Alien cash relief payments.....	1,470	1,470	1,470	1,470	1,470	1,470	1,470
Death and disability payments.....	1,450	1,261	1,260	1,253	1,253	1,253	1,253
Provision for uncollectable accounts.....	781						
Miscellaneous funded expense.....	3,106	3,486	3,363	3,269	3,217	3,217	3,017
Non fund expense.....	884	373	377	377	377	377	377
Cost transfer.....	(290)	(290)	(290)	(290)	(290)	(290)	(290)
Subtotal.....	27,868	20,914	20,775	18,716	17,393	17,280	2,1467
Total, general and administrative expense	55,448	47,763	47,564	45,146	43,615	43,502	47,689
Interest.....	20,058						
Other:							
Grounds, refuse, and other direct expense.....	5,075	3,577	3,577	3,527	3,477	3,477	3,477
Nonfund expense.....	106	106	106	106	106	106	106
Cost transfer.....	(3,902)	(3,438)	(3,438)	(3,388)	(3,338)	(3,338)	(3,338)
Net expense.....	1,279	245	245	245	245	245	245
Community, custodial and other direct expense.....							
Nonfund expense.....	2,986	2,309	2,309	2,225	2,141	2,141	2,141
Cost transfer.....	2	2	2	2	2	2	2
Net expense.....	(2,874)	(2,248)	(2,248)	(2,164)	(2,080)	(2,080)	(2,080)
Agency press and duplicating center direct expense.....	114	63	63	63	63	63	63
Nonfund expense.....							
Cost transfer.....							
Net expense.....	1,391	1,162	1,162	1,102	1,084	1,084	1,084
Nonfund expense.....	29	29	29	29	29	29	29
Cost transfer.....	(1,379)	(1,196)	(1,196)	(1,136)	(1,118)	(1,118)	(1,118)
Net expense.....	41	(5)	(5)	(5)	(5)	(5)	(5)

## DETAILED STATEMENT OF OPERATING COSTS AND REVENUES—Continued

[In thousands of dollars]

	President's budget 1979	Estimates with treaty-imposed changes					
		1979	1980	1981	1982	1983	1984
OPERATING EXPENSES—Continued							
Miscellaneous canal expense:							
Annuity to Panama.....	519	-----	-----	-----	-----	-----	-----
National policy school sponsorship of tuition students.....	847	-----	-----	-----	-----	-----	-----
National policy health sponsorship of former employees.....	6,473	5,761	5,761	5,761	5,761	5,761	5,761
Canal protection services.....	3,441	3,202	3,202	3,202	3,202	3,202	3,202
Thatcher Ferry bridge operation and maintenance.....	758	-----	-----	-----	-----	-----	-----
Salvage depot and Balboa drydock.....	470	369	369	369	369	369	369
Other funded costs.....	747	1,004	1,029	1,029	1,029	1,029	1,029
Accrual for marine accidents and casualty losses.....	4,200	4,200	4,200	4,200	4,200	4,200	4,200
Other nonfund expense.....	939	398	398	398	398	398	398
Cost transfer.....	(1,232)	(7)	(7)	(7)	(7)	(7)	(7)
Net expense.....	17,162	14,927	14,952	14,952	14,952	14,952	14,952
Total, other expense.....	18,596	15,230	15,255	15,255	15,255	15,255	15,255
Government activities:							
Customs-immigration:							
Funded costs.....	1,584	166	166	166	166	166	166
Nonfund expense.....	1	1	1	1	1	1	1
Net expense.....	1,585	167	167	167	167	167	167
Postal service:							
Funded costs.....	3,119	166	125	83	46	35	-----
Nonfund expense.....	16	-----	-----	-----	-----	-----	-----
Net expense.....	3,135	166	125	83	46	35	-----
Police protection:							
Funded costs.....	9,892	8,923	8,170	4,361	1,220	1,220	1,220
Nonfund expense.....	101	101	101	50	-----	-----	-----
Net expense.....	9,993	9,024	8,271	4,411	1,220	1,220	1,220
Fire protection:							
Funded costs.....	4,246	3,784	3,784	3,784	3,784	3,784	3,784
Nonfund expense.....	86	76	76	76	76	76	76
Net expense.....	4,332	3,860	3,860	3,860	3,860	3,860	3,860
Judicial system:							
Funded costs.....	334	191	189	99	-----	-----	-----
Nonfund expense.....	-----	-----	-----	-----	-----	-----	-----
Net expense.....	334	191	189	99	-----	-----	-----
Public areas and facilities:							
Funded costs.....	4,446	2,398	2,398	2,398	2,398	2,398	2,398
Nonfund expense.....	930	376	376	376	376	376	376
Net expense.....	5,376	2,774	2,774	2,774	2,774	2,774	2,774
Education/libraries:							
Funded costs.....	24,398	628	583	583	583	583	583
Nonfund expense.....	664	-----	-----	-----	-----	-----	-----
Net expense.....	25,062	628	583	583	385	583	583
Internal security:							
Funded costs.....	367	301	301	301	301	301	301
Nonfund expense.....	-----	-----	-----	-----	-----	-----	-----
Net expense.....	367	301	301	301	301	301	301
Other civil affairs:							
Funded costs.....	937	519	482	261	281	281	281
Nonfund expense.....	10	8	8	8	8	8	8
Net expense.....	947	527	490	269	289	289	289



## DETAILED STATEMENT OF OPERATING COSTS AND REVENUES—Continued

[In thousands of dollars]

	Presi- dent's budget 1979	Estimates with treaty-imposed changes					
	1979	1980	1981	1982	1983	1984	
OPERATING EXPENSES—Continued							
Hospitals and clinics:							
Funded costs .....	28,160						
Nonfund expense .....	712						
Net expense .....	28,872						
Other public health services:							
Funded costs .....	4,884	2,188	2,182	2,163	2,163	2,163	
Nonfund expense .....	19	3	3	3	3	3	
Net expense .....	4,903	2,191	2,185	2,166	2,166	2,166	
Office of the Governor: Funded costs .....	407	373	373	373	373	373	
Other general government expense:							
Employment costs:							
Government cost for health benefits .....	1,488	312	288	186	185	185	
Recruitment and repatriation .....	892						
Employee's states travel .....	876	168	143	62	62	62	
Transport of employee's vehicles .....	192	37	31	14	14	14	
Government cost for FEGLI .....	298	62	58	37	37	37	
Government cost for FICA .....	183	8	8	9	9	9	
Death and disability payments .....	327	301	301	298	298	298	
Alien cash relief payments .....	122	122	122	122	122	122	
Government buildings, lands and sites .....	1,041	910	892	811	730	730	
Other funded costs .....	28	28	28	28	28	28	
Nonfund expense .....	216	121	121	117	113	113	
Net expense .....	5,663	2,069	1,992	1,684	1,598	1,598	
Net expense governmental activities .....	90,976	22,271	21,310	16,790	13,377	13,366	
Total, operating expenses .....	390,996	219,800	218,571	211,024	206,022	205,923	
REVENUES AND RECOVERIES, OTHER THAN TOLLS							
Navigation service and control .....	30,975	27,209	27,209	27,209	27,209	27,209	
General repair, storehouse, engineering and maintenance services .....	5,500	1,127	1,065	784	484	484	
Marine terminals:							
Harbor terminals .....	21,965						
Marine bunkering .....	6,248						
Total, marine terminals .....	28,213						
Transportation and utilities:							
Railroad .....	2,621						
Motor transportation .....	424						
Water transportation .....	3,690	5,408	5,319	5,253	5,181	4,413	
Power system .....	12,958	15,708	15,780	15,919	15,986	15,986	
Communications system .....	1,052	905	841	799	775	775	
Water system .....	4,073	3,933	3,933	3,933	3,934	3,934	
Central air-conditioning .....	66	783	783	783	783	783	
Total, transportation and utilities .....	24,884	26,737	26,656	26,687	26,659	25,891	
Retail and housing:							
Retail units .....	36,790						
Food units .....	4,058						
Theaters and bowling alleys .....	431						
Employee housing, ABC .....	4,990	4,850	4,850	4,850	4,850	4,850	
Employee housing, DEF .....	1,015						
Total, retail and housing .....	47,284	4,850	4,850	4,850	4,850	4,850	
Other:							
Maintenance of channels and harbors .....	223	128	1,628	128	128	128	
Grounds, refuse and other service .....	1,596	309	309	309	309	309	
Community, custodial and other services .....	117	66	66	66	66	66	
Agency press and duplicating service .....	51	5	5	5	5	5	
Miscellaneous .....	378	170	157	157	157	157	
Total, other .....	2,365	678	2,165	665	665	665	
Total, canal operating revenues other than tolls .....	139,221	60,601	61,945	60,195	59,867	61,359	

## DETAILED STATEMENT OF OPERATING COSTS AND REVENUES—Continued

[In thousands of dollars]

	President's budget 1979	Estimates with treaty-imposed changes					
		1979	1980	1981	1982	1983	1984
REVENUES AND RECOVERIES, OTHER THAN TOLLS—Continued							
Government activities:							
Customs—immigration.....							
Postal service.....	1,979						
Police protection.....	51	51	51				
Fire protection.....	5,422	2,578	2,578	2,578	2,578	2,578	2,578
Judicial system.....	200						
Education/libraries.....	24,407						
Other civil affairs.....	846	4	4	2	2	2	2
Hospitals and clinics.....	32,341						
Other public health services.....	813	15	15	15	15	15	15
Other general government expense.....	63						
Total, governmental activities.....	66,122	2,648	2,648	2,595	2,595	2,595	2,595
Total, revenues and recoveries, other than tolls.....	205,343	63,249	64,593	62,790	62,462	63,954	61,694

<sup>1</sup> Amounts are net of Canal Zone Government sponsorship.

*Question 3(b).* What specific provisions of the proposed Canal treaties and related documents would probably increase costs of the Canal? What provisions would tend to decrease costs?

Answer. There are presented below only those provisions of the treaty that would have a major impact on the cost of operation of the Canal.

## PROVISIONS THAT INCREASE COSTS

*Fixed Annuity to Panama of \$10 million; Payment to Panama of \$0.30 per Panama Canal Net Ton, with adjustment provisions*

These provisions will increase substantially the annuity costs being borne by the Canal. The Canal presently pays \$519 thousand of a total annuity to Panama of \$2,328 thousand. Under the treaty provisions, the cost burden will at the outset increase to an amount in excess of \$50 million annually. Moreover, the \$0.30 per Panama Canal net ton rate will increase in line with inflation starting with the sixth year after the treaty comes into force.

*Discontinuance or transfer of certain Canal Zone Government activities. Payment to Panama of \$10 million annually for specified public services, including police and fire protection*

The net effect of the treaty provisions that pertain to Canal Zone Government activities will be to increase the cost by about \$5 to \$8 million annually for the duration of the 30-month transition period. This comes about essentially because the Commission will be required to maintain residual though decreasing government functions, in addition to assuming a \$10 million payment to Panama for public services.

*Discontinuance of commercial activities, such as marine terminals and bunkering services*

This requirement will tend to increase the cost of operation of the Canal by foregoing the net revenue contributed by these activities as a whole to the overall profit and loss picture of the Canal.

*Establish training programs for Panamanian employees and apprentices*

It is anticipated that this requirement will result in additional costs to the Canal over present training expenses, particularly in the area of apprentices.

*Reorganization*

The requirements of the treaty to discontinue various functions will impose a cost burden on the Commission for several years for such items as severance pay, repatriation and relocations of offices and other physical plant.

*Annual contingency payment of \$10 million to Panama*

To the extent revenue permits and actual payment is made to Panama, these payments will represent an additional cost to the Canal.



## PROVISIONS THAT DECREASE COSTS

*Discontinuance of retail stores, food units, and recreational facilities*

In accordance with established policy, these services have been provided historically at comparable U.S. prices in order not to burden the employee unfairly as compared to his counterpart in the United States. The resultant underrecoveries will be eliminated under the treaties.

*General and administrative expenses*

It is expected that overhead expenses following completion of reorganization will be reduced as a result of the treaty requirement to shed activities and functions. For example, the Commission will continue to incur costs for such items as health care and education for its employees and their dependents, but at a reduced level due to the decline in workforce. General expenses should also decline because of a reduced requirement for administrative and staff personnel.

*Interest on the U.S. investment*

In fiscal year 1977, the Canal paid \$18.1 million into the Treasury as interest accrued for that year. Although not specifically provided in the treaty, it is understood that proposed enabling legislation will relieve the Commission from such interest payments after the treaty becomes effective.

*Question 3(c).* What are the estimated costs of operation (by operational activity) of the Panama Canal for fiscal year 1978 as shown in the budget program for that year, approved by the Congress in the Department of Transportation and Related Agencies Appropriations Act, 1978? How would each of those figures and the total be changed by the treaties?

Answer. Rough estimates based on preliminary review and analyses reflect the following:

## THE PANAMA CANAL ENTERPRISE

The financial effects of superimposing the proposed Panama Canal treaties on the latest budget estimates of financial results for fiscal year 1978 are reflected on the attached pages.

Several points must be considered when analyzing this data, namely:

1. These figures represent the first year under the new treaty. They are conservative in nature and do not reflect the impact which North Slope oil may have upon Canal revenues.

2. Transition costs, which are shown as \$9.679 million in the attached schedule will be eliminated several years after the treaty's effective date.

3. The expenses associated with governmental activities, approximately \$22 million, will be reduced as the three-year jurisdictional transition period passes. For example, some \$9 million, allocated for police activities, will be eliminated after three years.

4. It should be noted that in 1980, we expect to increase capital requirements by \$7 to \$10 million annually.

5. Setting aside inflation, Canal operating costs might be somewhat reduced after the initial transition years of the treaty; however, price index increases made to annuity payments will serve to consume any excess revenues which we may forecast.

THE PANAMA CANAL—OPERATING STATEMENT SHOWING EFFECT OF TREATY CHANGES SUPERIMPOSED ON FISCAL YEAR 1978 BUDGET ESTIMATE—PRELIMINARY ESTIMATE SUBJECT TO FURTHER REFINEMENTS

[In thousands of dollars]

	1978 budget	1978 with treaty changes
Operating expenses:		
Maintenance of channels and harbors.....	22,563	1 22,603
Navigation service and control.....	40,732	38,316
Locks.....	24,759	24,759
General repair, storehouse, engineering, and maintenance services.....	8,966	9,108
Marine terminals.....	19,801	1,659
Transportation and utilities.....	22,137	1 25,353
Retail and housing.....	51,504	6,303
Other.....	44,886	41,383
General and administrative.....	26,231	25,662
Governmental activities.....	85,968	1 22,097
Public service payments to Panama.....		10,000
Repayment of prior year's interest costs.....	5,273	1 5,273
Subtotal.....	352,820	232,516

See footnotes at end of table.

THE PANAMA CANAL—OPERATING STATEMENT SHOWING EFFECT OF TREATY CHANGES SUPERIMPOSED ON  
FISCAL YEAR 1978 BUDGET ESTIMATE—PRELIMINARY ESTIMATE SUBJECT TO FURTHER REFINEMENTS—Continued

[In thousands of dollars]

	1978 budget	1978 with treaty changes
Operating expenses—Continued		
Interest.....	19,706	
Fixed annuity to Panama.....		10,000
Annuity based on Panama Canal net tonnage.....		42,471
Total operating expenses.....	372,526	284,987
Revenues other than tolls:		
Navigation service and control.....	29,962	26,247
General repair, storehouse, engineering, and maintenance services.....	6,062	3,155
Marine terminals.....	24,151	1,645
Transportation and utilities.....	23,950	126,521
Retail and housing.....	47,169	5,866
Governmental activities.....	63,132	115
Other.....	2,351	3,068
Total revenues other than tolls.....	196,777	66,617
Net costs without tolls.....	175,749	218,370
Capital outlay expenditures in excess of depreciation.....	7,133	( <sup>4</sup> )
Transition costs:		
Severance pay.....		6,093
Repatriation.....		1,350
Plant relocations.....		2,236
Total transition costs.....		9,676
Total recoverable from tolls in 1978 dollars.....		228,049
Toll revenues at existing rates.....		177,637
Net deficiency in toll revenue.....		50,412

<sup>1</sup> Both costs and revenues in "Transportation and Utilities" and "Maintenance of Channels and Harbors" increase due to reclassification of internal credits for intra-agency services, an offset to costs, to a revenue transaction representing services provided activities transferred to other government agencies and the Republic of Panama.

<sup>2</sup> The restated figures for governmental activities include principally cost for fire, sanitation and industrial health services, sewers and public areas maintenance, and on transitional basis, police and courts.

<sup>3</sup> The 1977 budget estimates repayment to the Treasury of \$5,400,000 in unearned costs withheld in prior years. The actual repayment in 1978 will be made to the extent earned, and the balance, if any, repaid from earnings projected for fiscal year 1979.

<sup>4</sup> It is expected that capital outlay expenditures will be constrained so as to approximate the level of depreciation charge through the transition period. However, over the long run, capital outlay expenditures will range between \$7,000,000 and \$10,000,000 in excess of depreciation.

Question 3(d). What is the estimated cost of capital replacements and improvements shown in the 1978 budget for 1978 and the years immediately following? How would the capital program be affected by the changes indicated in the proposed treaties?

Answer. The following are the estimated costs of capital replacements and improvements for the Company and Government for fiscal years 1978 and 1979. Fiscal year 1980 costs are currently being developed.

[Obligational dollars in thousands]

Fiscal year 1978:	
Panama Canal Company.....	\$22,000
Canal Zone Government.....	2,851
Fiscal year 1979:	
Panama Canal Company.....	22,000
Canal Zone Government.....	2,335

If the Treaty were ratified in the second half of fiscal year 1978 there would be negligible impact on the fiscal year 1978 capital programs. However, the impact on fiscal year 1979 programs would be anticipated to result in the following levels:

[Obligational dollars in thousands]

Fiscal Year 1979:	
Panama Canal Company.....	\$18,870
Canal Zone Government.....	1,122



*Question 4.* What elements of the proposed treaties and accompanying documents have implications for the accounting, and especially the depreciation policies of the agency that operates the Canal?

*Answer.* The provisions of the treaties that would most heavily impact on the accounting and depreciation policies of the Commission would be those addressing: the properties that would be transferred to the Republic of Panama; the activities the Commission would be prohibited from operating; the use-rights the Republic of Panama grants the United States for housing units to be used to house U.S. citizen employees of the Commission; and the payment of the \$10 million annuity to the Republic of Panama to the extent revenues exceed expenditures after the other annuity payments to the Republic of Panama have been made.

*Question 5.* Many studies have confirmed that a majority of Canal expenses are fixed expenses which cannot be reduced if Canal traffic declines or other operational difficulties arise. For example, Arthur Andersen & Co. prepared a study which indicates that 65% of Canal expenses are fixed. Under the proposed Panama Canal Treaty, when certain activities now performed by the Company are transferred to Panama or the U.S. military, what will be the proportion of fixed costs to all costs of the Panama Canal Commission?

*Answer.* The Arthur Andersen & Co. report referred to was completed in November 1970 and was based on a comprehensive, detailed, and extensive study of costs of the Canal organization. A similar cost analysis must be made before the new ratio between fixed and variable costs under the new Treaty can be determined. We have not been able to proceed with this analysis because our study of treaty-related costs is not yet complete.

Our preliminary assessment is that such study would show that the relationship between fixed and variable costs will remain about the same, even after shedding various activities and functions and assuming the higher annuity payments.

*Question 6.* Taken from the viewpoint of operating the Canal, what would be the best construction of the term "or its equivalency" as used in paragraphs 4(a) of Article XIII of the treaty providing for the payment to Panama of \$.30 per Panama Canal net ton "or its equivalency, for each vessel transiting the canal . . . for which tolls are charged?"

*Answer.* "Equivalency" means that any measurement system other than the current one should yield an amount proportional to the 30 cents per Panama Canal net ton now accorded to Panama by the Treaty. One such new system, the "Universal Measurement System", could conceivably apply in the future to Panama Canal traffic. If it does, the relationship between Panama Canal net tons and the new tonnage would have to be established, which would in turn determine the equivalent ton payment to Panama.

In another more specific case, "equivalency" will have to be established for the current tolls base. Tolls are now \$1.29 per Panama Canal net laden ton and 72 cents per displacement ton. Since the Treaty specifies payment only on the basis of Panama Canal net tons, we will adjust the amount payable for displacement tonnage passing through the Canal after the treaty enters into force. At current rates, a payment of 17 cents per displacement ton would be made to Panama.

*Question 7.* Given a need to estimate the effect on Canal Commission costs of the provision of Article XIII, paragraph 4(a) for adjustment of the payment of \$.30 per Panama Canal ton "to reflect changes in the United States wholesale price index for total manufactured goods", what portion of Canal expenses would this part of the payment to Panama represent?

*Answer.* We are unable to predict the changes in the United States wholesale price index for total manufactured goods; however, if we were to assume an average 6 percent annual inflation factor (see attached schedule listing from 1967 through 1977 the average wholesale price index for manufactured goods), this would result in the following (assuming effective date of treaty is the beginning of FY 1979):

Dollars in thousands]

	Fiscal year 1979	Fiscal year 1984
Rate of payment to Panama, per Panama Canal net tonnage (cets).....	30	33.7
Total payment to Panama based on tonnage projections assuming 40-percent toll increase with January 1975 sensitivity curves.....	\$40,830	<sup>1</sup> \$50,620
Total projected expenses.....	\$236,963	\$297,264
Percent payment to expenses.....	17	17
Total payment to Panama with no toll increase.....	\$43,230	<sup>2</sup> \$55,550
Total projected expenses.....	\$239,363	\$302,194
Percent payment to expenses.....	18	18

<sup>1</sup>Of this amount, \$4,506,000 is accounted for by application of the inflation factor.<sup>2</sup>Of this amount, \$4,945,000 is accounted for by application of the inflation factor.

## WHOLESALE PRICE INDEX FOR TOTAL MANUFACTURED GOODS

Year	Average <sup>1</sup>	Percent of year-to-year Increase
1967.....	100.0	-----
1968.....	102.6	2.6
1969.....	106.2	3.5
1970.....	110.2	3.8
1971.....	113.8	3.3
1972.....	117.9	3.6
1973.....	129.2	9.6
1974.....	154.1	19.3
1975.....	171.1	11.0
1976.....	178.9	4.6
1977.....	<sup>2</sup> 187.6	<sup>2</sup> 6.1

<sup>1</sup> Averages for 1967 to 1976 are for calendar years.<sup>2</sup> Average for 1977 is based on 6 months through June 1977; the percent increase is over the same 6 months of 1976:

	1977	1976
January.....	184.1	175.3
February.....	185.3	175.6
March.....	186.9	176.0
April.....	188.8	177.1
May.....	190.2	177.7
June.....	190.4	178.9
Total.....	1,125.7	1,060.6
Months.....	÷6.0	÷6.0
Average.....	187.6	176.8

Source: Survey of Current Business and 1971 Business Statistics. The indexes for 1976 were confirmed by referring to table 3 of the "Wholesale Prices and Price Indexes," published by the Department of Labor.

**Question 8(a).** From the viewpoint of Canal accounting, how do you recommend the determination be made of the extent to which revenues of the Canal exceed expenditures for purposes of the \$10 million payment to Panama provided for by Article XIII, paragraph 4(c) of the treaty?

Answer. We are recommending that in determining the adequacy of operating revenues for the purpose of payments to Panama under paragraph 4(c) of Article XIII, the operating revenues of a given fiscal period will first be reduced by all expenditures of that period including amounts paid or payable for operations and maintenance, inventory, plant, goods, services and that portion of unfunded liabilities paid or currently payable, including the payments to Panama under paragraphs 4(a) and 4(b) of Article XIII and under paragraph 5 of Article III of the treaty, as well as the cumulative sum from prior years of any excess of expenditures over operating revenues, as defined above.

**Question 8(b).** Should "expenditures" as used in that provision be exclusive of obligations?

Answer. Expenditures would not normally include obligations for outstanding but unperformed contracts and purchase orders. However, obligations for major items such as improvements would constitute an expenditure within the meaning of the provision.

**Question 8(c).** Should "expenditures" as used in that provision include reserves for future operating requirements and capital replacement and betterments?



Answer. Expenditures as used in this provision would not normally include any reserves for future operating requirements such as the provision for marine accidents, overhauls, etc. With respect to reserves for capital replacement and betterments, we are recommending that the tolls formula be revised to permit generation of funds for these capital items and that any such funds generated be segregated and held for future capital use.

Question 9. How would you recommend the annual amount of up to \$10 million for payment to Panama under Article XIII 4(c) of the treaty be treated—

(a) on the books of the agency operating the Canal?

(b) in the determination of tolls rates?

if no further policy guidance were forthcoming as to the structure and accounting of the Commission?

Answer. (a) I recommend that only that portion of the \$10 million annuity that the Commission can pay in accordance with the provisions of this Article and subparagraph, Article XIII 4(c), be booked as a liability of the Commission and that that portion of the \$10 million annuity which the Commission cannot pay be treated as a contingent liability of the Commission and be reflected in its Statement of Financial Condition by means of a footnote.

(b) I understand that the \$10 million per year is only a contingent payment and thus is not an element that must be recovered through tolls. Therefore, any payments made under the provisions of this Article and subparagraph would not be an expense of the Commission but rather a reduction of the Commission's equity.

Question 10(a). Article III, paragraph 5 of the proposed Panama Canal Treaty provides for an annual payment of \$10 million, examined every three years, for the provision of certain public services by Panama. What is the present cost to the Canal enterprise of those services; how are they funded; and what is the projected annual cost to Panama for each one of the services?

Answer. Predicated upon fiscal year 1979 cost estimates for the involved seven (7) public services under our current mode of operation, and recognizing that the scope and mission of these public services will be limited to only Commission operating and housing areas, our comparison of costs (whether provided by the Commission or Panama) reveals the following:

Public services (1)	Entire present Canal Zone Company/Gov- ernment cur- rent cost esti- mates (2)	Public services related only to Commission operating and housing areas <sup>1</sup>	
		Estimated cost to Commission if services pro- vided by Com- mission (3)	Estimated cost to R.P. if services provided by Panama (4)
Police.....	\$10,204,000	\$6,457,000	\$1,045,418
Fire protection.....	4,362,000	1,776,000	1,722,000
Street maintenance.....	2,592,000	553,000	553,000
Street lighting.....	489,000	234,000	234,000
Street cleaning.....	116,000	96,000	96,000
Traffic management.....	92,000	36,800	36,800
Garbage/trash collection.....	1,788,000	740,000	740,000
Total cost.....	<sup>2</sup> 19,643,000	9,892,800	4,427,218
Less: Recoveries:			
Police.....	51,000		
Fire.....	2,889,000		
Garbage collection.....	1,556,000		
Total recoveries.....	<sup>3</sup> 4,496,000	9,892,800	4,427,218
Net operating cost.....	<sup>4</sup> 15,147,000	9,892,800	4,427,218

<sup>1</sup> This comparison of costs assumes that the quality and level of public services provided Commission operating and housing areas will be equal to those currently available—whether such public services are rendered by either Panama or Commission employees. In view of the unique nature of their work, it does not appear practical to assume that police personnel would relocate along with a transfer of function to Panama. Thus, with the exception of police, costs remain essentially the same under both alternatives due to transfer of personnel and continuation of current earnings in accord with the spirit and intent of the treaty. Costs and recoveries for public services outside Commission operating and housing areas are not included.

<sup>2</sup> Actual fiscal year 1977 was \$15,842,000.

<sup>3</sup> Actual fiscal year 1977 was \$3,417,000.

<sup>4</sup> Actual fiscal year 1977 was \$12,425,000.

The net cost of these public services is basically a cost to the Panama Canal Company. However, because of statutory requirements to account for Canal Zone Government data on a separate basis the major portion of the public services are funded initially by Canal Zone Government appropriations. These appropriations are then repaid to the U.S. Treasury by the deposit of revenues collected for fire and certain police services and deposits by the Panama Canal Company for the net cost of Canal Zone Government. The exception to this is the garbage and trash collection which is a Company activity, a large portion of which is recovered from military agencies and others. A small portion of the garbage collection costs are charged against the Canal Zone Government appropriations and then repaid by the Panama Canal Company as a portion of the net cost of the Canal Zone Government.

*Question 10 (b).* Article III, paragraph 5 states that adjustment of the annual payment "should be made because of inflation and other relevant factors affecting the cost of such services (provided)". Given the experience of the Panama Canal organization in the administration of public services in the Canal Zone, what specifically should be used as the inflationary indicator for adjustment, and what are the "other relevant factors" cited in the Treaty?

Answer. At the present time, I am not aware of any indicator applicable to the Republic of Panama which could be used to measure the effect of inflation on the cost of providing the services listed in Article III, paragraph 5 of the Treaty. However, with the cooperation of the Government of Panama, it is possible that an inflationary indicator could be developed for use in determining whether adjustment to the annual payment would be necessary when costs are reexamined.

The commitment is to pay for the costs incurred by Panama. The review every three years will reassess the actual cost to Panama. In determining these costs, the United States and Panama will look at the effects of inflation as well as other relevant factors such as the cost of labor, materials, etc.

*Question 11.* What amount of liabilities (by fiscal year and in total) to present employees of the Canal organization are expected to be incurred by the U.S. Government as a result of the proposed treaty arrangement? What are expected to be the sum of liabilities to employees of the Commission for each of the first several years of the Commission's existence?

How will the per capita and total amount and proportion of personnel costs of the Panama Canal Company and Canal enterprise compare with personnel costs under the proposed Commission? Upon what assumptions are the estimates of personnel costs based? (For example, do you assume that the minimum wage and tax factor will continue to be in force? Because of the treaty provision that protects terms and conditions of employment?)

Answer. As previously mentioned, the Company has in progress a comprehensive study of the cost impact of the treaty. Information pertaining to the liabilities to employees of both the Canal organization and the Commission, as well as changes in personnel costs, will be determined from this study. The data requested will be furnished the Subcommittee upon completion of the study.

Relative to severance pay and repatriation costs, we have preliminary estimates that indicate first year costs of approximately \$6.1 million for severance pay and \$1.4 million for repatriation.

With respect to the liability identified with a proposed liberal retirement plan, the final plan has not been decided upon. However, the Administration released on November 21 an early retirement proposal for union consultation and consideration. The Civil Service Commission has estimated the cost of this proposal at \$135 million to be financed by Congressional appropriations at the rate of \$4 million per year for a period of 30 years.

For calculating personnel costs under the Commission, it is assumed that current wage practices will be continued. It is also assumed that the minimum wage will apply to Commission employees after the treaties come into force. However, the U.S. minimum wage will not apply to the private sector, including contractors of the Commission. These assumptions depend on the provisions of the final implementing legislation.

*Question 12.* How will the cost of living for U.S. and Panamanian employees of the Canal be affected by the terms of the treaties? Will any change in the cost of living of employees affect the personnel costs of the Canal Commission and the prospective liabilities of the U.S. government to employees?

Answer. U.S. and non-U.S. citizen employees of the Panama Canal Company/Canal Zone Government will be affected in their cost of living in different ways.



U.S. citizen employees and those recruited from outside of Panama will have the use of DOD-operated hospitals and schools for the life of the Treaty and military sales purchase privileges for the first five years. It is anticipated that legislation will be sought to compensate these employees with a cost of living allowance after the first five years.

Non-U.S. citizens will lose commissary privileges (immediately), health and education privileges (after specific periods or conditions); further, they will not be allowed military sales purchase privileges.

Personnel costs of the Commission should increase to cover any cost of living increase authorized. The cost of living increase would be calculated prior to its enactment five years after Treaty implementation. The exact amount would depend on the number of eligible employees and the difference in costs to them from purchasing in the Republic of Panama rather than in United States Government facilities.

**Question 13.** What are the projected costs by fiscal year for the training programs which might be initiated under Article X, paragraph 3(b) of the Panama Canal Treaty?

Answer. Attached is a schedule showing the estimated costs for one possible program which might be initiated under Article X, paragraph 3(b) of the Panama Canal Treaty. This assumes a treaty effective date of October 1, 1978.

PROJECTED ADDED COST OF NEW AND EXPANDED TRAINING PROGRAMS FOR PANAMANIAN EMPLOYEES AND APPRENTICES UNDER THE PROPOSED NEW TREATY

Items	Estimated costs (in thousands)			
	Fiscal year 1978	Fiscal year 1979	Fiscal year 1980	Fiscal year 1981
Expanded apprentice program:				
15 additional apprentices each year (90 versus 75).....		39	210	294
2 additional instructors for the apprentice school.....		28	37	37
1 additional clerk for the apprentice school.....		6	8	8
Installation of security fencing to protect apprentice school tools and equipment.....		57		
Capital equipment (machine tools, trainers, etc.) for apprentice school.....	15	10		
Noncapital equipment supplies and materials for apprentice school.....	20	15	15	15
Specialized and expanded on-going training (skill, supervisory, and managerial):				
2 additional instructors for training and management development.....		28	37	37
2 additional language instructors (English and Spanish language training).....		11	33	33
1 additional clerk for training center.....		6	8	8
Audiovisual aids training equipment and supplies.....		10	10	10
Specialized training (off-isthmus and contract).....		50	50	50
Salaries and benefits of 10 additional towboat master/pilot trainees.....		100	250	400
Total.....	35	360	658	892

Note: Existing classroom space is adequate to meet the additional training requirements of the new treaty. Suitable facilities will be sought in buildings available to the Panama Canal Commission. For this reason no costs are projected above for this purpose. However if such facilities were to be constructed, an estimated \$250 000 capital expenditure would be required in fiscal year 1979.

**Question 14.** The present Panama Canal enterprise has been described by you and many others as a highly interdependent organization in which changes in one part of the organization greatly affect other offices, bureaus, etc. The Annex to the Panama Canal Treaty lists 20 types of activities now carried out by the Panama Canal Company and Canal Zone Government which are not to be undertaken under the Panama Canal Treaty.

(a) How will the cessation of those activities by the Canal enterprise affect the total financing of the Canal?

Answer. In responding to this question, the police protection function should be addressed separately. For the transition period, this function will be continued by the Commission and, accordingly, there will be no substantial reduction in these costs. Both during and after the transition period, the Commission will be obligated to pay \$10 million annually to Panama for this and other services.

We have not separately identified the net effect of elimination of the other specified activities. It is noted, however, that many of them contribute positively to the current profit picture of the Company. We do have tentative estimates that show that the net effect of all functional changes, excluding transitional costs, will be a net saving of \$19 million. This will contribute toward the payments to Panama of \$10 million for public services, \$10 million fixed annuity, and 30¢ per Panama Canal ton.

*Question 14(b).* What is the annual profit or loss to the Company/Government of each of these activities?

Answer. There is shown below the cost or margin realized in FY 1977 for each of the subject activities. In furnishing this data, it should be emphasized that in most cases, neither the cost nor margin shown is representative of the cost impact under the treaty. There are several reasons for this. First of all, the police, prison and court functions are to be continued by the Commission during the transition period. Second, the margin results shown do not reflect overhead costs; these costs will undoubtedly be affected by cessation of the activities. Finally, many of the services will still be required by the Commission and have to be provided by outsiders. To the extent that the rates accessed the Commission for such services differ from the prior cost, the results will alter the profit and loss picture.

<i>Activity</i>	<i>Fiscal year 1977 margin (cost)</i>
Retail units (includes laundry and production plants)-----	\$(2,755)
Food units-----	(232)
Theaters and bowling alleys-----	(229)
Motor transportation (commercial)-----	99
Railroad (including Panama freight house)-----	(470)
Marine bunkering operations-----	216
Terminals operations-----	3,646
Printing services-----	4
Health-----	(175)
Education-----	3,653
Postal services-----	(794)
Customs and immigration-----	(1,368)
License section-----	294
Magistrates courts-----	(50)
Maintenance division (centralized maintenance services)-----	318
Industrial division (vessel repair)-----	1,079
Electrical division-----	181
Launches-----	257
Tugs (harbor)-----	402
Subtotal-----	4,076
Less: Police protection (includes prison system)-----	(8,604)
Total-----	(4,528)

*Question 14(c)* In what manner and in what amounts will the activities that continue be carried on by the Commission be affected by the cessation of possibly interdependent activities?

Answer. At this time we can provide no definitive answer as to how the cessation or partial cessation of certain activities will specifically affect the activities that continue to be carried on by the Commission. This matter is being considered as part of the comprehensive cost analysis which is scheduled for completion in January of 1978.

*Question 15.* Maps drawn in accordance with the proposed Panama Canal Treaty show a plethora of military areas adjacent to operating areas of the Panama Canal Commission. Further, the treaty and its implementing agreements prescribe subjects for coordination between the Commission and the military. What are the costs of coordination of administration likely to be (under the proposed treaty) and how will the financial responsibilities for administration be divided?

Answer. The treaty recognizes the need for coordination between the Commission and the U.S. military agencies and for a continuation of relationships between agencies on a basis similar to that which exists today between the Panama Canal Company/Canal Zone Government and the military. It is not possible



at this time to identify the costs that might be associated with the coordination between agencies. However, in those cases where one agency can be expected to utilize the facilities or services of another agency it is anticipated that it will be done on a cost reimbursable basis under interservice support agreements as is presently the normal practice; e.g., the provision of power, water, educational and medical services, etc.

*Question 16(a).* The Panama Canal Treaty does not appear to contain any language restricting the ability of the Commission to provide wholly-owned modes of transport to the U.S. If this absence of language imposes no restrictions, is it understood that the asset of vessel SS *Cristobal* would become the property of the Commission?

Answer. Yes; it is contemplated that the SS *Cristobal* will become the property of the Commission.

*Question 16(b).* How would the costs of transportation and resupply associated with the present functions of the SS *Cristobal* be affected by the treaties?

Answer. Upon entry into force of the Treaty, the Panama Canal shall cease to operate such retail activities as commissaries, department stores and food outlets. During FY 1977, these units accounted for 27 percent of the 183,801 measured tons carried on the SS *Cristobal*. However, since the U.S. employees of the Commission and their dependents will be eligible to purchase in military commissaries and post exchanges for five years, it is possible that the military tonnages on the SS *Cristobal* will increase correspondingly to accommodate the added workload. In such cases, the impact on the SS *Cristobal* operation due to treaty implementation will be minor.

*Question 16(c).* If the U.S. did not retain the services of the *Cristobal* under the auspices of the Commission, how would the cost of services associated with the functions of the *Cristobal* be affected?

Answer. This would probably result in increased costs. Numerous studies have been made of the SS *Cristobal* to determine the need for its continuation. All of the studies, the latest of which was completed in July 1976, have concluded that this Company-controlled operation has produced significant cash savings to the Canal agency.

*Question 17.* What provisions for emergency infusions of resources must be made to keep the Canal operating in event of cessation of operations under the proposed treaties?

Answer. The Panama Canal Company has under existing law the authority to borrow up to \$40 million from the U.S. Treasury and the authority to seek appropriations to cover funding requirements beyond those that can be met out of its operating revenues. The retention of these two funding provisions would provide the Commission with the mechanism for obtaining the necessary resources to keep the Panama Canal Commission operating under adverse or emergency circumstances.

The amount of the borrowing authority should be reviewed periodically for adequacy, especially in light of the loss of authority to defer payments to the U.S. Treasury which now amounts to in excess of \$40 million.

*Question 18.* In addition to meeting its operating expenses, the Panama Canal Company now has a number of statutory financial obligations such as payment on the net direct investment of the United States in the Canal enterprise, repayment of any appropriations made to cover Canal losses, and several other obligations. In view of the obligations to the Republic of Panama incurred under the proposed treaties, should the present financial obligations of the Canal to the U.S. be reconsidered? Which requirements would be least needed or relevant under the proposed Commission?

Answer. The Panama Canal Company is required under existing law to reimburse the U.S. Treasury for the net cost of the Canal Zone Government and to pay into the U.S. Treasury interest on the United States' net direct investment in the Panama Canal Company. The Panama Canal Company also has under existing law the authority to borrow up to \$40 million from the U.S. Treasury and the authority to seek appropriations to cover funding requirements beyond those that can be met out of its operating revenues.

Upon entry into force of the Panama Canal treaties, the Canal Zone Government and Panama Canal Company are prohibited from continuing to operate in the Republic of Panama. Instead a new Government agency named the Panama Canal Commission will be constituted by and in conformity with the laws of the United States to carry out the United States' responsibility under the treaties.

As a result of these treaty provisions, the reimbursement of the U.S. Treasury for the net cost of the Canal Zone Government becomes, per se, irrelevant since the agency would no longer exist. However, it should be recognized that the Commission would still bear the cost of those services formerly provided by the Canal Zone Government to the extent such services are still provided for the benefit of the Commission, except that the Commission would incur the cost of these services directly instead of through the net cost of the Canal Zone Government as the Panama Canal Company now does. The Commission would as a result of this financing arrangement lose the backstop financial flexibility the Panama Canal Company now has through the withholding of payments to the U.S. Treasury for the unearned net cost of the Canal Zone Government.

With reference to the Company's present obligation to pay interest to the U.S. Treasury on the United States' net direct investment in the Panama Canal Company I understand that the Administration will seek repeal of this requirement. Although the elimination of this obligation has the effect of offsetting the Commission's increased obligations to the Republic of Panama, by the amount of the annual interest payments, the Commission's backstop financial flexibility would also be affected because under the present law the interest obligation to the U.S. Treasury only has to be paid when it is earned.

The two statutory funding provisions that now authorize the Panama Canal Company to borrow funds from the U.S. Treasury and to seek appropriations to cover funding requirements beyond those that can be met out of its operating revenues should be carried forward to the Commission. These funding provisions would provide the Commission with the mechanism for obtaining the necessary resources to keep the Panama Canal Commission operating under adverse or emergency circumstances.

*Question 19.* Article III, paragraph 3 of the Panama Canal Treaty provides that the United States shall carry out its responsibilities in reference to operation of the Canal by means of a U.S. Government agency "which shall be constituted by and in conformity with the laws of the United States of America." Given the projected financial obligations which the Panama Canal Commission must meet within its overall mission of running the Canal efficiently, what form do you believe the U.S. Government agency should take?

*Answer.* In terms of management and operations, an organization along the lines of the present Panama Canal Company would probably be the most efficient and flexible. That agency has demonstrated, during the 26 years since its creation, that it can operate the Canal efficiently and, accordingly, it would seem advisable to have the new Panama Canal Commission organized, as closely as possible, along those same lines.

*Question 20.* Assuming the treaties are ratified, would revenue from tolls at present rates cover the cost of operation of the Panama Canal, together with facilities and appurtenances related thereto, as required by the tolls formula enacted by Congress?

Since it has been estimated that the provisions of the new treaties would require increases in rates of tolls of from 25 to 46 percent, or possibly more, and assuming increases in rates of tolls of that range:

(a) What effect would such increases have on traffic through the Panama Canal, especially for U.S. shippers and on U.S. consumers?

*Answer.* Studies completed prior to the toll rate increases of 1974 and 1976, indicated that toll rate increases of 25 and 46 percent would reduce cargo tonnage from that forecast through the Canal by 2.7 and 3.1 percent, respectively, by 1985. With the implementation of the two toll rate increases and of the measurement rule changes, tolls have been effectively increased by approximately 50 percent. It is not precisely known what the effect would be of additional toll rate increases beyond stating that if all prior toll rate increases are considered cumulative an additional 25 percent increase would take Canal tolls above the maximum calculated in the pre-toll increase studies. If they are not, the latitude to increase tolls would be greater.

In order to more precisely answer the question of toll rate impact, the Department of State and the Panama Canal Company have commissioned International Research Associates to forecast Canal traffic and to analyze the potential, long term effects of toll rate increases. The results of the study will be available in late January, 1978.

Based on prior analyses, such as the study "The Economic Value of the Panama Canal," dated December 1973, the added burden to the U.S. economy of any increase in tolls would be about one-third of the total increase.



*Question 20(b).* What alternatives to the use of the Canal would be available to present U.S. users?

Answer. Different alternatives are available to different users depending on the commodity and trade route, and alternatives to the Canal would change over time, but basically, the following types of alternatives would be available:

1. Bypass of Canal by vessels too large to transit the Canal, such as is now occurring to a significant degree in the U.S.-Far East coal trade;

2. Changes to different modes of transport such as the combination ocean/land bridge-mini bridge concepts currently operational in the U.S., pipeline, and air;

3. Changes in sources of supply, as for example with a commodity like alumina/bauxite. (Alumina/bauxite moves both ways in Canal traffic and swapping arrangements are apparently feasible.) ; and

4. Changes in markets such as happened with iron ore from the west coast of South America. In 1960, for example, iron ore shipments through the Canal peaked at 8.7 million long tons with current levels of approximately 2.8 million tons reflecting the change in demand patterns as much of the iron ore from the west coast of South America shifted to new markets in Asia.

*Question 20(c).* How do such alternatives compare to the cost of use of the Canal at present rates and at rates reflecting increases to 25 percent to 46 percent?

Answer. Except in isolated instances, we have no direct knowledge of how current rates (Canal vs alternatives) compare. The most recent study now available to us indicated the sensitivity of various commodities to toll increases. These sensitivity estimates serve as general indicators of estimated cost difference over time. For example, what was estimated to be sensitive to any toll increase over 25 percent with maximum revenues being achieved at about 150 percent. Bananas were found to be sensitive to toll rate increases of less than 25 percent with the maximum revenue being achieved at 25 percent. Each commodity/trade route is different but the general approximations of sensitivity indicate the difference between Canal costs and the costs of alternatives.

The Department of State and the Panama Canal Company have commissioned a study to be completed in January 1978, which will review the alternatives open to shippers and will establish sensitivity estimates based on current toll rates.

*Question 20(d).* What would be the comparative effect of tolls increases in the first year of the increases and in succeeding years?

Answer. Pre-toll rate increase studies indicated that a toll increase of, say 25 percent, would yield a net return in the first year of 24.4 percent, a return of 22.6 percent in the fifth year, and 22.2 percent in the tenth year, at which time the effect of the toll increase would have stabilized. We will have an updated and more definitive answer on the effect of toll rate increases when the newly commissioned study is completed in January 1978.

*Question 20(e).* How would changes in the magnitude indicated affect the economies of the U.S., Europe, Central America, South America, Japan, Asia, Australia and New Zealand?

Answer. There are no current studies which delineate the potential effect of additional toll increases of between 25 and 46 percent on the economies shown above. All studies completed prior to the various toll rate increases since 1974, have indicated that no nation's economy would be severely affected by toll rate increases of these magnitudes. In general, the effect would probably be minimal on the larger, less dependent economies and more heavily felt by the smaller economies more dependent on the Canal.

Although the question will not be addressed specifically by the study currently underway, it will be possible to draw references from it as to the general impact of new toll rate increases on Canal users by nation.

*Question 21.* To what degree would non-toll fees associated with the use of the Canal (pilotage, bunkering, etc.) be affected by the terms of the treaties?

Answer. There is no requirement to change the system of fees for services such as pilotage, linehandlers, etc., which will continue to be performed by the Commission. Those services, such as bunkering, which are to be provided by Panama will be subject to charges determined by Panama. Both Panama and the Panama Canal Commission are obligated by the Treaty to establish charges that are "just, reasonable, equitable, and consistent with the principles of international law."

*Question 22.* Would user charges for services now provided by the Canal organization and transferred by the Treaties to the U.S. military or the Government of Panama or Panamanian private enterprise be affected?

Answer. At this time, we do not know what the specific charges for services will be from the military or the Republic of Panama. There are general and varying constraints on charges to be levied on U.S. agencies and U.S. citizen employees and dependents by Panama. However, except for transit and ancillary services which are required to be just, reasonable and equitable, I am informed that there are no treaty constraints on charges to other users.

*Question 23.* From the viewpoint of the operator of the Canal, what procedures are now instituted to insure compliance with international user guarantees and how would such measures be modified, if at all, under the proposed treaties?

Answer. The procedures now instituted are set forth in Title 35 of the Code of Federal Regulations, principally in Part 131.

There are two operating practices which will be affected by the proposed treaties. First, under present rules, the United States is entitled to obtain, as a condition of transit, information concerning the origin, cargo, and destination of all vessels; under the proposed neutrality treaty vessels of war and auxiliary vessels would be entitled to refuse to disclose to Canal officials such information. Second, under present regulations use of the Canal by enemies of the United States is restricted during wartime; under the proposed neutrality treaty, the United States cannot exclude on this basis.

*Question 24.* What is the effect of the provisions of the Hay-Pauncefote treaty and of the 1903 treaty with Panama in regard to the practice and method of levying tolls for the use of the Panama Canal? To what extent are the same provisions reflected in the proposed new treaties?

Answer. Under the old and new treaties, the United States has the authority to set tolls. The only treaty constraints are that they be non-discriminatory, just, reasonable and equitable. We would envision that the implementing legislation would make no substantial changes in the internal United States procedures and standards for setting tolls. However, it should be noted that the Panama Canal Consultative Committee established under paragraph 7 of Article III of the Panama Canal Treaty shall advise both Governments concerning general tolls policy. Moreover, Panama will have an increased input into the tolls process by virtue of its participation on the Board and in the management of the new Commission.

#### ADDITIONAL QUESTIONS

##### *I. Introductory*

Article VI, Paragraph 6 of the Agreement in Implementation of the Panama Canal Treaty provides that the Panama Canal Commission "shall on behalf of the utilities agencies of the Republic of Panama continue to provide utilities such as power, water, and sewers to industrial and commercial enterprises and other enterprises and other persons in the area, other than United States citizen employees and dependents." The paragraph further states that Panama will set the rates and bill customers for the utilities, and reimburse the Commission for providing services.

*Question A.* What is the projected cost of continuing to provide utilities such as water, power, and sewers to Panama?

Answer. The Treaty states that Panama shall reimburse the Commission for its cost in providing such services. We do not believe that these costs will vary substantially from those that would obtain without a Treaty.

*Question B.* What rates have been used or will likely be used by Panama in billing customers?

Answer. We do not know what rates Panama will use, but we presume they will assess the same rates as they charge other customers in the Republic of Panama.

The Panama Canal Company's rates for furnishing potable water presently range from an average of 27 to 47 cents per 1,000 gallons, depending on the category of customer. Panama's current rates for the same general category of customers range from 77 cents to \$1.11 per 1,000 gallons.

The Panama Canal Company's electric power rates range from an average of 23 to 46 mills per kilowatt hour, again depending on the category of customer, while the rates in Panama range from 66 to 77 mills per kilowatt hour.

The Panama Canal Company presently charges \$7.000 per month for telephone services provided to residents in the Canal Zone and \$6.50 per month for com-



mercial service. The system allows unlimited telephone calls without operator assistance to any number within the Canal Zone and toll free calls to Panama's terminal cities. Panama charges \$10 per month for residential users and \$20 per month for service to commercial users. Under the Panama system, calls to Canal Zone numbers are subjected to toll charges.

*Question C.* How much differential has there been or will there likely be between the amounts charged by Panama on the one hand and the cost to the Commission on the other?

Answer. At this time, we do not know what the differential will be between the costs incurred by the Commission for providing these services and the rates charged by Panama to the users.

*Question D.* If Panama is to reimburse the Commission for the cost in providing such services, can this reimbursement be an accounting offset against the amount to be paid by the U.S. in Articles III and XIII?

Answer. The Panama Canal treaties do not provide for the offsetting of any amounts the Republic of Panama owes the Commission against the amounts the Commission owes the Republic of Panama. There appear to be advantages in the arrangement suggested and we see no bar to making such an arrangement with Panama.

*Question 01.* What is the projected cost of the obligations incurred by the U.S. under para. 3(c) of Art. VIII of the Agreement in Implementation of Article III of the Panama Canal Treaty provision which requires a matching sum for the purchaser of an equity in the Panamanian Social Security System by former Canal employees hired by the Government of Panama?

Answer. There should be no additional obligation incurred by the United States in matching the amount of contributions transferred by employees electing to purchase an equity in the Social Security System of Panama if such matching funds are withdrawn from the Civil Service Retirement Fund. The United States Government earlier incurred this cost when the Agency's contributions were made to the Civil Service Commission Retirement Fund for these employees.

*Question 02.* What will be the effect of Article IX of the Agreement in Implementation of Article III of the PC treaty on the carriage of goods by the SS *Cristobal*? This Article requires acquisition of Panamanian goods where comparable in quality and price to alternative sources.

Answer. The management of the Panama Canal enterprise has increasingly over the years followed a policy of procuring supplies and services from the Republic of Panama whenever the Canal's criteria on quality, reliability and costs have been met. Consequently, I would not expect the amount and nature of cargo carried on the SS *Cristobal*, after the treaties enter into force, to be materially affected by the provisions of this Article in itself. This will have to be reevaluated periodically during the life of the Treaty.

*Question 03.* What will be the costs to the Commission of the Requirement imposed by Para. 5 of Art. X of the PC Treaty that the U.S. establish "a policy of periodic rotation, at a maximum of every five years, of U.S. citizen employees and other non-Panamanian employees, hired after the entry into force of this treaty"?

Answer. The present average cost of recruiting an employee with a family from the United States is \$5,300 and the repatriation liability is \$6,000. Last fiscal year we recruited 30 employees in occupations that the Panama Canal Commission will utilize and which would be subject to the periodic rotation requirement of the treaty. Assuming some increase in this number as a result of increased turnover after ratification, it is estimated that 45 such employees will need to be recruited from the United States during each of the first three years of the treaty. Thereafter, the number should begin to decrease by an estimated 10% a year. Further assuming that the recruited employees serve for a full five years, the cost of the rotation policy is estimated at a minimum of \$5 million for the life of the treaty.

*Question 04.* Must the land licenses issued in connection with Article IV of the Agreement Implementation of Article III of the Panama Canal Treaty be issued without charge?

Answer. Under the provisions of paragraph 2 of Article IX of the Panama Canal Treaty, Panama has made a commitment to allow private business and non-profit organizations located in the present Canal Zone to continue to operate "at those locations under the same terms and conditions" prevailing prior to

the entry into force of the Treaty for a thirty-month transition period thereafter. At a minimum, therefore, the phrase "the same terms and conditions" would include the express terms of any land licenses currently issued by the Canal Zone Government. As a matter of policy the Canal Zone Government does not now impose any administrative fees or charges for the preparation and issuance of land use licenses.

As far as the charges for the use of the land itself are concerned, Article IX of the Panama Canal Treaty provides that owners of buildings and other improvements to real property located in areas subject to the licensing procedure established in Article IV of the Implementing Agreement will be authorized to continue using such land as outlined in that Article. Since these are areas made available for the use of the United States under the Treaty, the United States must agree to terms and conditions of any land licenses to be issued. Presumably the United States will continue the present Canal Zone Government policy of charging rentals only for land areas used for commercial purposes.

With respect to those areas not subject to the land use licensing procedure established in Article IV of the Implementing Agreement, paragraph 5 of Article IX of the Treaty provides that the owners of buildings located thereon "may continue to use the land upon which their property is located subject to the payment of a reasonable charge to the Republic of Panama." Subject to this standard of reasonableness, the amount of land rental rates to be charged in these cases would, of course, be decided by Panama.

*Question 05.* In Article VI of the Agreement in Implementation of Article III of the PC Treaty, the U.S. transfers to Panama all right, title, and interest in the housing areas now operated by the PCC. Panama then places at the disposal of the U.S., without cost, the use of such housing as is needed for housing to U.S. employees. How would the use of such housing be related to the accounting of the Panama Canal Commission and how would user charges, if any, be configured for such housing?

*Answer.* We would propose that the Panama Canal Commission establish use-right assets for those houses the Republic of Panama grants the United States for its use. These use-right assets would be established using the net book value of each house as recorded in the books of the Panama Canal Company and would be amortized at the same annual dollar value as they were depreciated under the Panama Canal Company books. The unamortized use-right for any house turned over to the Republic of Panama during the life of the treaty would be written off against the equity of the Commission.

Rental rates for these housing units would be established following the Panama Canal Company's present rental comparability policy which follows the guidelines contained in OMB Circular A-45.

*Question 06.* Article VIII 2(d) of the Agreement in Implementation of Article III of the PC Treaty stipulates that the Commission's contribution to the Social Security System of the Republic of Panama for each applicable employee would be equal to what the Commission would have paid under the Federal Employees Health Benefits Plan. On what basis are employers' contributions computed under the Panamanian Social Security System? Is there any difference between the figures which would be derived from the normal employer contribution under the Panamanian Social Security system as compared to the Federal Benefits Plan?

*Answer.* The employers' contribution to the Panama Social Security System is 8.75 percent of the employees' monthly salary. We have been informed that only a small portion (1 percent or less) of this amount is apportioned to the Health and Maternity Benefits Program of the system. All of the employee's contribution of 6.75 percent is apportioned to the Health and Maternity Benefits Program.

Effective January 2, 1978, the Company/Government's contribution to the Federal Employees' Health Benefits Plan for family coverage is \$694.00 per annum per employee regardless of the employee's rate of pay.

The average annual rate of pay for non-U.S. citizen employees is presently \$8,425.00. The employers' contribution to the Panama Social Security System on this amount would be \$737.00 per annum, of which about \$84 is apportioned to the Health and Maternity Benefits program.

Mr. BOWEN [presiding]. Thank you. I am pleased to be presiding when two very good friends and two dedicated public servants are testifying.



Both of you are doing an outstanding job in your respective capacities.

I would like, at this time, to ask both of you just a few questions.

Mr. Secretary, in my visits to the Canal Zone and the opportunities I have had to meet with employees down there in the last few years—my last visit being 1 year ago at approximately this time—I found that their great concerns have been over employment problems, over early retirement, over their concern that the Defense Department should be concerned about transfers to other positions, and over Federal employment here in the United States. I think all of us here in the Congress are very deeply concerned about this entire area.

We are hearing from our constituents who live down there. We are hearing from people who are writing to us who are not constituents. They are all concerned about the question of compensation of employees, how they will be paid, and to what extent employees are being consulted.

Could you comment just on this area?

Secretary ALEXANDER. Yes, Congressman Bowen, it has been a continuing concern of the employees and also of mine as a Stockholder of the Panama Canal Company.

In a trip to the Canal Zone last March, I met with leaders of employed groups. I have also met with individuals here in Washington and with Governor Parfitt. Additionally, there have been meetings between employee groups and members of my staff.

I feel that it is imperative for us to make those benefits which are offered to employees as fair as possible, particularly to those who are involuntarily separated. We have to be fair as well to those who may choose to leave voluntarily, but we must not provide benefits which encourage people who are now good employees and would continue to be good employees with the Panama Canal Commission to leave. It is that kind of balanced approach that we want to achieve as we try to develop employee benefits that would be equitable to the individuals involved.

I would place the highest priorities on those who might be involuntarily separated if the treaties are ratified.

Mr. BOWEN. I note particularly in my part of the country, the South, where we have a strong military tradition, that many of us do have constituents who serve in the Canal Zone in one capacity or another, we get a good deal of mail. We hear a great deal from employees who are concerned that our Government show the same kind of concern for them that we seem to show for the Panamanians.

So you feel that you have an established structure of consultation with employees and that you have a clear-cut decisionmaking process established for determining employee benefits and compensation?

Secretary ALEXANDER. I do feel that we have established this consultation and we have a continuing cognizance of the claims of individual employees or those who would serve to represent them.

I do think that Governor Parfitt, his staff and I have a management responsibility to try to weigh those items that are presented to us, looking at them from the perspective of our national interest and from the point of view of the organization running the canal. From that information we then try to make some sensible and equitable adjust-

ments. Obviously we cannot accept every recommendation that an individual or an employee group would make. However, it is our obligation to fully consider them.

Mr. BOWEN. That is a good analysis. I found in past years when I visited down there that one observation was that they did not expect to win on every issue, that they just wanted to be consulted.

They wanted to believe and know that somebody cares about them. I think probably in the last year or so, since I have been there, there has been some substantial development of involvement of employees in what is going on around the country. It makes them aware that somebody cares about them. I think you are heading in that direction.

Secretary ALEXANDER. They have a rightful claim to consultation. Governor Parfitt pointed out that as the negotiations were going on, employees were given very little information. As early as March of this year, we provided them with general information as to what might take place under a new treaty. There has been some discouragement about not having all of their questions answered, but from my personal meetings with employees, they have been quite pleased that we have been as forthcoming as we have.

Mr. BOWEN. I am pleased to hear that.

Governor Parfitt, let me ask you a question, too. I know in response to one of the questions that the subcommittee put to you, you indicated that the relationship of fixed and variable costs of allied operations would be the same, 65 and 35.

Would it not be the case that the payments to Panama under the treaty would be an additional fixed costs and that, in fact, would alter substantially the ratio that you spoke of?

Governor PARFITT. Our first assumption was that it would be different. However a quick estimate indicates it would not be. Our judgment now is still that the ratio would be about two-thirds to one-third.

Mr. BOWEN. So despite the increase in fixed costs, you expect the variable costs to go up so the ratio will remain somewhat the same?

Governor PARFITT. The net effect shows the same relationship would prevail.

Mr. BOWEN. I note that earlier this year, this fall, the Wall Street Journal quoted you as saying, "I am concerned about our ability to generate tolls enough to meet the requirements of the treaty." Would you comment on this?

Governor PARFITT. As an operator, I have just gone through a very difficult financial situation. I take a conservative view on the ability of the canal to generate money. There is a development on the scene right now which, in the short term, looks very favorable and will change the outlook for the short term. That is the North Slope oil. My outlook is more optimistic. I remain very conservative and very concerned as to what our studies may show with regard to midterm and long term, but I would prefer to await the conclusion of our detailed studies.

Mr. BOWEN. Speaking of the Alaskan oil situation, do you feel that the increase in tolls will have any effect on the transit of Alaskan oil through the canal?

Governor PARFITT. No. We do not think that situation will be affected by any change in toll rates. There are other factors which determine whether it will go through the Panama Canal or not.



Mr. BOWEN. What about whether the cost of operating the canal might be more closely tied to the economy and inflationary conditions in the Republic of Panama? Do you think that is a possibility?

Governor PARFITT. There are always possibilities in the Panama Canal. Our costs of supplies and materials are affected by inflation both in Panama and the United States.

Mr. BOWEN. Mr. Secretary, I know that in your answers to questions for the record, you mentioned that governmental authority and responsibility of the canal should not be fragmented, that only one agency should have the responsibility for supervising the canal. Will you elaborate further on that for us?

Secretary ALEXANDER. Yes, sir. It seems to me that in order to have the efficient management that is required by the canal enterprise, it would be logical to have one unit of the executive branch exercise responsibility, with clearly delineated lines to the President of the United States. If multiple agencies are involved, representing the Congress, the public, and the users, then to put a finger on who is responsible becomes more and more difficult.

I do think that the past history of canal operation has indicated that the present arrangement has worked pretty well and, therefore, an entity that is structured in a similar vein, until December 31, 1999, when the canal passes to Panama, would seem to make sense.

Mr. BOWEN. Referring to earlier testimony with respect to the employee situation, another issue is the goal that you have in reducing the canal employees' cost of living so as to keep to a minimum the recruitment necessary.

Would you give us an observation on that?

Secretary ALEXANDER. Governor Parfitt has indicated with respect to recruitment that our long-term goal is to have as many Panamanians as possible involved in the running of the canal. I am sure the committee knows that presently three-fourths of the employees of the Panama Canal enterprise are Panamanian. It would seem that if we can keep seasoned people and provide adequate training, as is called for in the treaty, then the transition can be orderly, and the same level of service that people have come to expect of the canal will be maintained beyond the year 2000 when the Government of Panama assumes full responsibility.

Mr. BOWEN. Perhaps just one further question which I might direct to Governor Parfitt.

There has been a lot of speculation about what the attitude is in the other Latin American countries. A number of people have suggested that a great many Latin American nations are not particularly enthusiastic about the treaties, but they feel obligated to their Latin American neighbors to support it publicly. Privately they have indicated substantially less than enthusiasm for the treaties.

Whether or not that is accurate, I don't know. I would like to ask you whether or not you have heard from other Latin American countries or from Latin Americans about the subject of toll increases and what their attitude would be. Some project an increase of 30 or 40 percent. You said optimistically you hoped the traffic would be such that it might be as low as 25 percent. Let us assume it would be 40 percent.

What have you heard from Latin American shippers?

Governor PARFITT. We heard from our Latin American neighbors that they did not take kindly to an increase in toll rates. They don't like the prospect because it impacts on their economies more so than it does on the United States.

I have not heard any indicate that the feeling was so strong as to sway their political decision which is to support the treaties.

Mr. BOWEN. As to elasticity of demand and use of the Canal, what kind of surveys did you make and what conclusions did you come to regarding use of the canal as a result of an increase in tolls?

Governor PARFITT. Our last studies were completed in 1974. There are similar studies which we won't have until January. At that time, we will know more about the sensitivity.

Mr. BOWEN. This is a subject which is discussed throughout Congress, and it is of great interest throughout the country—what the impact would be on the citizens of the canal in having the toll charges go up. We will look forward to those studies.

Governor PARFITT. Our data predates two toll increases. We need another sampling, and we expect to have the results in the latter part of January.

Mr. BOWEN. At the rate we are going, that will give us plenty of time for consideration here in Congress.

I believe counsel for the minority does have some questions he would like to ask.

Mr. NONNENMACHER. Mr. Secretary, I have a question that borders on the political area.

As Ambassador Bunker pointed out, the contingent payment of \$10 million a year to Panama would be possible only if the canal would operate efficiently enough to make a surplus. You said you hoped it continued to provide operating and maintenance costs.

What would happen if the Panamanian Government insisted that this contingency of \$10 million should be considered as a basic cost in view of the structure of the Commission? It is American-Panamanian 5 to 4, but is there any likelihood of any real political hassle over that? Do you think that is pretty well taken care of?

Secretary ALEXANDER. My recollection of the treaty language would indicate that it is taken care of. It is contingent upon the surpluses which would actually exist. There is the accumulation feature that is also provided for in the treaty. If in 1 year there were a \$5 million "profit" over and beyond the 30-cent toll payment, the \$10 million fixed payment, and other costs, then the \$5 million not paid would be carried forward to the following year.

I do not sense that there is any lack of clarity on the part of the Panamanian negotiators as to the interpretation of this provision.

Mr. NONNENMACHER. Is there any question in your mind as to any possible trouble at the end of the 23-year period with the Panamanians demanding a lump sum for any of that accumulative sum that has not been paid?

Secretary ALEXANDER. No.

Mr. NONNENMACHER. You think that has been clarified? There would be no such demand?

Secretary ALEXANDER. As I remember, the earlier demands from the Panamanian negotiators were for an initial payment of \$1 billion, and over \$100 million a year. Our negotiators, I think quite skillfully,



determined a figure that would be paid and which was in the realm of reason while at the same time relates directly to the earnings of the Company. There is no expectation, as I understand it, that if there is an accumulation of unpaid \$10 million contingent payments, that the sum would be due at the end of the treaty period. The United States assumes no obligation in this regard. There is no indication in the treaty language and certainly, from my knowledge, there is no indication from the negotiations that Panama has such an expectation.

Mr. NONNENMACHER. Thank you.

I have another question. This is regarding your proposal that after the first 5 years of the treaty, when employees will no longer be authorized to use the PX's and commissaries, additional compensation would be provided to employees to offset associated increases in their cost of living. They will receive a hike or boost in pay.

I do not think you have given any estimates what that would cost. It would be of help to receive such an estimate.

In view of the history of the building of the canal, it is my understanding that the PX's and commissaries were established because Panama had a monopoly on all the goods and services required by employees, and the employees could not even break even on their wages, so the U.S. authority set up the PX's and commissaries in order that they could earn enough money over and above what they had to pay out.

There is a possibility, I do not say it is going to happen, but Panama might find itself in that monopoly situation again. Will the prices be held down to modest prices, or be raised where we might find, even to our sorrow that we had not continued the PX's? I just throw that out as a background to show that in my opinion it is going to be hard to gage what the cost of living might be, and what your employees additional compensation will have to be if we don't know what the prices will be that Panama will charge for the goods they no longer can get at the PX's and commissaries.

Secretary ALEXANDER. We do not have precise figures. However, there would be a saving of some \$3 million as the result of not having to run the stores presently operated by the Panama Canal Company. We think that the cost of living differential would probably be less. We do not have a precise figure. When we do, we will see that it is provided to the committee.

[The following information was supplied:]

Precise computations cannot be made until we are well into the new treaty period.

Mr. NONNENMACHER. Thank you.

Mr. METCALFE (presiding). Mr. Tannenbaum, do you have any questions?

Mr. TANNENBAUM. Yes.

The Comptroller General and others have pointed out numerous financial issues not clarified in the treaties which would have a devastating impact depending upon the interpretation. Won't these issues, if not resolved before treaty approval, eventually result in future disputes with Panama?

Governor PARFITT. There is a potential. I would hope it would be treated under legislation that is contemplated by the administration.

MR. TANNENBAUM. I believe the Comptroller General stated that there are a number of financial issues that must be resolved. There is a tremendous economic package which is up in the air. I wonder if Panama realizes that this economic package is up in the air. Wouldn't they consider it a breach of good faith if they did not receive the economic package or if they did not receive the \$10 million additional sum or if, as you say, there is an increased current evaluation of the assets allowed and recouped for the United States or if interest is returned to the United States on its investment?

All of these factors, if the implementing legislation call for repayment, would increase the tolls substantially more than 40 percent?

Governor PARFITT. If I understand you correctly, certainly, if the Congress were not to approve the waiver of the interest payments, it is now about \$18 million, that would be an added cost to the toll structure and therefore again, bump against the sensitivity curves.

MR. TANNENBAUM. And the reserve for replacement not contemplated in the 40-percent figure?

Governor PARFITT. The 40-percent figure would include in our judgment right now a reservation of enough funds for capital investments, increased amounts required beyond depreciation.

We have included in our cost estimates a factor which runs about \$7 to \$10 million in extra funds required above depreciation accruals. That has been used in our estimate to determine expectations of what moneys are needed and our 40 percent would derive those moneys if our estimates are accurate.

We would generate enough money to pay off the capital programs and our operating-maintenance cost.

MR. TANNENBAUM. I know I asked a complex, compound question before. I do not recall your responding to the question as to Panama's reaction if we were to seek recoupment of these expenses?

Governor PARFITT. I don't know, but the negotiators in Panama understand contingent payment is clearly that. If there is no requirement of the U.S. Government to pay unless it can be generated as surplus from operating revenues and there is no requirement to pay Panama at the termination—I am told they understand it now. I do not know about the future. The treaty seems to cover the contingent payment, that we only pay it from operating revenues if revenues are in excess of expenditures. It remains for us to define the revenues and expenditures. We hope to do that in the implementing legislation.

MR. TANNENBAUM. I have one more question.

Congressman Murphy feels that leaving such vital issues up in the air would create more problems than they will solve. The treaty agreements as provided will lead to further disputes with Panama which we have not had.

Secretary ALEXANDER. I would differ.

The treaty is clear on the point of the contingent of \$10 million. I have heard no discussion from the negotiators or anyone else that there is a requirement to make a lump-sum payment for any accumulations at the end of the treaty period. I disagree with the characterization as made on that point.



Mr. TANNENBAUM. It is not my characterization. Comptroller General Staats has indicated at least half a dozen items in which there are serious ambiguities.

Secretary ALEXANDER. Then I would disagree that there are ambiguities regardless of who made such statements. I do not think ambiguity exists on these issues.

Governor PARFITT. Mr. Staats indicated that some of these issues were moot in the treaty—it didn't say one way or another—and it would have to be covered within the body of the legislation. The interest payment—he said clearly that we have to determine whether we will continue to pay interest on the investment.

The administration has announced, through negotiators, that they intend to seek legislation to remove the interest payments. We have a problem if the Congress refuses to accept that.

Mr. TANNENBAUM. That would create serious problems, would it not?

Governor PARFITT. Only if you are unable to generate the extra amount of money to make up for the interest payment of \$20 million—which is a distinct possibility.

Mr. TANNENBAUM. Thank you.

Mr. METCALFE. Thank you. I have just one final question to ask.

What is the rationale for the discontinuance of payment of interest on the investment?

Governor PARFITT. I am now aware of the rationale of the negotiators, just the determination they would seek legislation.

From the standpoint of the Commission, I view it favorably because of the uncertainty of the Commission to generate funds to meet all of its commitments. I am not familiar with the rationale that the administration would recommend that we no longer pay interest.

Mr. METCALFE. Thank you.

I would like to express our appreciation to Secretary Alexander for being with us today and also Governor Parfitt who is no stranger to us. We appreciate you coming before us. Thank you very much.

Secretary ALEXANDER. Thank you.

Governor PARFITT. Thank you.

Mr. METCALFE. The next witness will be Lt. Gen. W. G. Dolvin, Deputy Negotiator, Department of Defense for Panama Canal Negotiations.

Thank you very much for waiting. We will be happy to hear your testimony.

[The questions posed to the witness by the Subcommittee, and answered in the statement follow:]

#### QUESTIONS POSED TO DEPARTMENT OF DEFENSE

1. Please estimate at least the approximate value of real and personal property and assets of the U.S. Armed Forces (not the Panama Canal Company, Canal Zone Government or other non-military agencies) to be transferred to Panama (a) upon the entry into force of the treaty; (b) the value of all property and assets to be transferred subsequent to the entry into force of the treaty and before the termination of the treaty; and (c) the value of all property and assets that must be transferred by the termination of the treaty. Explain this by charts and graphs, if possible.

2. Will U.S. Government warships and similar craft pay tolls under the treaty?

3. If they will pay tolls, how will the payment to Panama of \$.30 per Panama Canal ton "or its equivalency" be determined for warships and other craft pay-

ing tolls on a displacement basis not measurable in Panama Canal tons? What will be the source of the funds used for payment of tolls on U.S. Government warships or similar craft that do not now pay tolls? What is the estimated amount of such tolls payments?

4. Under the Panama Canal Treaty what functions now performed by the Panama Canal enterprise will be assumed by the U.S. military agencies on the Isthmus of Panama? Will there be a need for additional Defense appropriations for the activities that are assumed? If appropriations are required, how much would have to be budgeted?

5. What will be the costs to the United States of the discontinuance of any military activity now conducted in the Zone and the commencement of that activity in another area?

6. What additional costs to the U.S. Armed Forces are expected as a result of any personnel actions with respect to civilian employees of the U.S. military in the present Canal Zone in connection with the proposed treaties?

7. Maps drawn in accordance with the proposed Panama Canal Treaty show a plethora of military areas adjacent to operating areas of the Panama Canal Commission. Further, the Treaty and its implementing agreements prescribe subjects for coordination between the Commission and the military. What are the costs of coordination of administration likely to be under the proposed treaties, and how will the financial responsibilities for administration be divided?

8. Will the U.S. military be responsible for payments to Commission for rights of U.S. forces on Commission lands, such as the use of Commission lands for military training?

9. Article II, paragraph 2(9) of the Agreement in Implementation of Article III of the Panama Canal Treaty states that Panama shall make the installations and equipment of the Naval Industrial Reserve Shipyard available in the event of an emergency involved with the protection and defense of the Canal. The U.S. would pay Panama for services provided. Who would pay these expenses, the Panama Canal Commission or the U.S. military?

#### **STATEMENT OF LT. GEN. W. G. DOLVIN (U.S. ARMY, RETIRED), DEPUTY NEGOTIATOR, DEPARTMENT OF DEFENSE FOR PANAMA CANAL NEGOTIATIONS**

General DOLVIN. Mr. Chairman, members of the subcommittee:

I am here today representing the Secretary of Defense and the Joint Chiefs of Staff to discuss Defense views of the economic/financial aspects of the proposed Panama Canal Treaties.

I will address those questions, which you included with your letter of invitation to testify before this subcommittee, as well as some other items of Defense interest.

At the outset, let me state that it is the position of the Office of the Secretary of Defense and the Joint Chiefs of Staff, that the Panama Canal is a major defense asset of strategic military importance and will remain so for the foreseeable future. Its principal value lies in the flexibility it provides in transferring our ships rapidly from one ocean to another. It is especially valuable as it applies to our logistical and amphibious shipping. It is because of its value that DOD is interested in a treaty arrangement which maximizes the possibility that we can continue to use the canal in peace and war in the future.

The new treaties make available to the United States those lands, waters and facilities necessary to garrison and train our troops. Those facilities which we will not require for our own purposes will be returned to Panama in accordance with a phased schedule. Some facilities revert on Treaty day, while others will revert to Panama when they are no longer required by the United States throughout the life of the Panama Canal Treaties, and others will revert to Panama upon termination of the Panama Canal Treaties. The undepreciated original



value of property transferred upon entry into force of the treaty is \$27.5 million; during the life of the treaty \$33.5 million; and upon termination of the treaty \$291.9 million for a total of \$352.9 million. No plan exists at this time to transfer any person or portable military property to Panama.

In accordance with the terms of the Panama Canal Treaties, the U.S. Government will continue to pay tolls for the use of the canal by its warships; however, under different procedural arrangements than are now in effect. Under the new treaties, a portion of the proceeds from the transit of our warships will be provided to Panama. The amount of tolls will be equivalent to 30 cents per Panama Canal ton which Panama will receive from merchant ships transitting the canal. Warships pay tolls based upon displacement tons rather than measurement tons. It is anticipated that the amount of tolls for warships will be proportionate to the tolls paid by merchant ships or about \$0.17 per displacement ton. Funds for these tolls will come from the operating budget of the user service.

Under the new Panama Canal Treaties, the principal functions now performed by the Panama Canal Company which may be assumed by Department of Defense agencies are health service care and dependent schooling throughout the life of the Panama Canal Treaties, as well as commissary, post exchange, and postal services for Canal Commission employees for a period of 5 years.

Services provided by the Department of Defense to the Canal Commission employees will be on a reimbursable basis. For example, in order to provide health care services to military personnel as well as to Canal Commission employees, the Department of Defense will budget for the operation of the hospitals but will be reimbursed for that number of Canal Commission patients utilizing these services. While this might result in an increase in appropriated funds, there would be no net increase to the U.S. Government.

Currently, there are no approved plans to discontinue major U.S. military activities in the Panama Canal area as a result of the new treaties. However, the merging of DOD and canal enterprise facilities could cause the loss of jobs for some military employees. If placement efforts are not successful, employees will be separated and generally, most will be eligible for severance pay, lump-sum leave settlement, and for U.S. citizens, relocation transportation costs to place of residence in U.S. It is not possible to estimate what these costs might be since that will depend on the number of employees that will be involved and the success of the placement effort.

We anticipate no payment to the Commission for rights of U.S. Forces utilizing Commission land. Most areas used by the military are either designated as Defense sites or areas of military coordination. However, in the event the military needs to use Commission lands, the treaties do not require payment. Likewise, we foresee no cost associated with coordination between the military and Panama Canal Commission. It is visualized that this coordination will be done by personnel regularly assigned other duties as is presently the case.

The treaties specify that the Naval Industrial Reserve Shipyard will be available in the event of an emergency for the protection and defense of the canal. Furthermore, it specifies that the Panama Canal Commission can utilize this facility on an as required basis. The parties

utilizing this facility will pay Panama for services provided on a basis no higher than other preferred customers.

In summary, Mr. Chairman, we anticipate that the new Panama Canal Commission and the U.S. military forces will continue to co-operate closely in matters of common interest; the operation and defense of the Panama Canal.

Thank you very much.

That concludes my statement.

Mr. METCALFE. Thank you very much.

You indicated on page 2 of your statement that "No plan exists at this time to transfer any personal or portable military property to Panama."

What do you mean by personal or portable military property? What is the meaning of that? Can it be that this property may be eventually transferred, but no plan exists at this time?

General DOLVIN. That statement was in answer to a question posed by the committee. The treaty deals with nonremovable property. In other words, it is anticipated that the equipment of the 193d Infantry Brigade would not be turned over to Panama. The treaty requires no transfer of military property.

Now, the only reason I phrased it that way, Mr. Chairman, is that there is a small amount of military equipment at the present time which is directly involved with the operation of the Canal, specifically some naval communications equipment. The Navy runs Radio Balboa, which communicates with ships coming in and out of the canal. I question whether that would be the case at the end of the treaty, but it is possible that something of that nature would take place. However, there are no plans, in the usual sense, for military equipment to be transferred as part of this treaty.

Mr. METCALFE. Thank you.

You indicated that U.S. warships will pay tolls to the Canal Commission. With respect to so-called auxiliary vessels, in wartime, a vessel such as those that are chartered by the military sealift command, for example, would the tolls of these be budget items for the military service?

General DOLVIN. In the case of cargo type or military sea transport vessels, they would pay tolls. However, that activity is industrially funded and the cost of the tolls would be passed on to customers.

Mr. METCALFE. With respect to the Naval Industrial Reserve Shipyard mentioned on page 5 of your statement, under what circumstances has that been used in the past?

How much does it cost, and when might we want to use it again?

General DOLVIN. I don't have precise figures, Mr. Chairman, for how much it has been used and at what cost. I can address it in general terms and I can provide you with that information. It is in standby now. The NIRS is owned in part by the Navy. The Navy pays the company to maintain the facility and equipment. It is used from time to time by the Canal Company and partly by the Commission as they need it.

The principal items in the facility are the drydocks. The company uses the drydocks to work on the lock gates, and in the event that a ship comes in and needs repairs, that facility performs that function.



Under the new arrangement, Panama would operate it, but the treaty stipulates that it can be used by the Navy or the Canal Company as and when needed. It has been used fairly infrequently other than for the lock gates in the drydock.

Mr. METCALFE. Thank you very much.

[The following information was supplied:]

#### DRYDOCK AND SUPPORTING FACILITIES

NIRS which consists largely of Panama Canal Company owned assets, including the major 1000 foot drydock and supporting facilities, is maintained for the Department of Defense by the Panama Canal Company under a letter of agreement between the Navy Department and the Panama Canal Company. The agreement provides that the Panama Canal Company performs necessary maintenance on equipment and facilities as determined by the Navy, as well as protection, on a reimbursable basis. The Company also furnishes utilities and related services on a reimbursable pro rata basis. Except for drydock one the Company must obtain written permission to use any item of equipment. The Company is responsible for funding repair and maintenance of equipment and facilities used by the Company on a nonreimbursable basis. The Navy has access to the facilities at all times. The Navy reimbursed the Panama Canal Company \$24,772.05 in FY-1977 for maintenance costs. When the US Navy has occasion to use the shipyard facilities Navy pays for services rendered. The last time a U.S. Navy ship used the drydock was approximately seven years ago. The Navy periodically used the drydock and shipyard facilities to conduct overhaul on a floating drydock on lease to the Ecuadorean Navy. The last time this was done was in 1976 (previous time was 1971). Periodically, miscellaneous repairs are conducted on Navy and Military Sealift Command ships at the shipyard but not using the drydock. Emergency repairs were performed on USS *Dahgren* in 1975 in this fashion after the ship was damaged in a collision in the Caribbean approaches to the Canal.

NIRS includes buildings 1, 1C, 1D, 1G, 1H, 1J, 2, 2A, 3, 4, 4B, 11, 12, 12A, 12X, 13, 17, 18, 20, 23, 25, 29, 29B, 30, 31, and 32. Eighteen of these buildings are scheduled to be turned over to Panama. The eight remaining buildings (1J, 2A, 3, 4, 12, 12A, 13, and 31) would be retained by the Panama Canal Commission. Equipment, some of which is in use by the Panama Canal Company, but most of which is in storage is located throughout most of the buildings. The equipment would be required if the shipyard was to be fully mobilized.

Mr. METCALFE. One final question from me.

A total of \$352.9 million for military assets would be transferred to Panama under the Canal Treaty by the year 2000. Could you describe the nature of these assets and tell us what a country with such a small army like Panama is going to do with the assets?

General DOLVIN. Yes, sir, the major assets will be transferred on treaty day are barracks and military structures. The facilities at Fort Amador and at Albrook East Pad Area will be turned over to Panama for use of the Guardia Nacional. A fair percent of the facilities is housing. In the case of Albrook-East, the Guardia Nacional would move in helicopters. We would move our facility to Howard Air Force Base.

As I stated in my statement, as we no longer need facilities during the life of the treaty, it is anticipated that they will be turned over to Panama.

At the end of the treaty period, we would turnover the barracks and the military installations which we have in the Zone.

Mr. METCALFE. Thank you. Does staff have any questions?

Mr. MODGLIN. Thank you, Mr. Chairman. I have two questions.

General, in hearings that the subcommittee held in July on U.S. interest in the Panama Canal, one witness, John Sheffey, made this

particular statement: "The Canal Zone is a very valuable logistical base for operations in Latin America, the Caribbean, and the Southern Pacific."

Then he went on and pointed out four different items.

It has the only major ship repair facilities within 1,600 miles on the Atlantic side and 2,500 miles on the Pacific side.

"It has the only U.S. controlled airbase within a thousand miles.

"It is a military communications and transportation crossroads for the hemisphere.

"It contains the only existing transisthmian pipelines for ship bunker oil and aviation fuel. In short, it is the only existing United States logistical base of any significance south of the United States.

With respect to those additional items, are there any costs that will be incurred as a result of discontinuance of any U.S. military activity with those four items?

General DOLVIN. During the life of the Panama Canal Treaty, Mr. Modglin, I think not. I will review that precisely because the facilities that you mentioned in your question still remain there. The airbase is still there. The ship facility is there. It is inactive but available as needed. Instead of its being an operation between the Canal Company and the Navy, it would be between the Navy and the Government of Panama.

The pipeline remains. The pipeline remains a Navy pipeline, but we have made provisions for its use by Panama on a reimbursable basis when we don't need it. It is not a very big pipeline, as you probably know.

You had one other question.

Mr. MODGLIN. One other question, General.

The agreement in implementation of article IV of the treaty provides defense arrangements with the canal be reviewed periodically. Would the reviews done now by the Joint United States-Panama Committee have any costs associated that we do not perceive; and in particular, might there be a situation in which the proposed agreement would be attenuated or changed before the year 2000, thus making for cost to the U.S. Government?

I am thinking in particular of the fact that there were no specific fees for U.S. military bases in Panama under the proposed treaty between now and 2000. If that treaty were revised?

General DOLVIN. You are right. There are no fees connected with it, and it is not anticipated that there will be. The reason for the provision of the 5-year review is to prevent it from being kind of a continuous review. As the treaty progresses and we get more experience operating under the new canal treaties, it is visualized that facility requirements will be reviewed. When it is determined that we do not need something any longer, our review could result in releasing facilities to Panama. Why we specified "after 5 years" is to avoid continuous reviews. I cannot visualize any circumstances under which it will add to the cost.

The "SOFA" will last as long as we have troops there.

Mr. MODGLIN. Thank you, General Dolvin.

Thank you, Mr. Chairman, for the time.

Mr. METCALFE. Mr. Nonnenmacher, do you have any questions?

Mr. NONNENMACHER. Thank you, Mr. Chairman.



General Dolvin, two questions.

Governor Parfitt in his testimony stated that some \$30 million of assets of the Canal Zone enterprise would be transferred to DOD agencies on the effective date of the treaty, of the \$330 million facility.

What, in general, are those particular facilities and, second, did you include that \$30 million figure in your figures on page 2 regarding the transfer of Defense Department property to Panama?

General DOLVIN. They are essentially hospitals and schools and, to a lesser extent, part of the facilities associated with commissaries. It is those buildings and structures which are now being used by the Canal Company for those functions which are to be transferred. The vast majority of facilities are for the schools and hospitals, and I will have to ask some of my experts on the second question.

It has not been included in my figures. It is in Governor Parfitt's figures.

Mr. NONNENMACHER. If it is transferred, it could go into your figures as to what is transferred at the end of the treaty when the 23 years run out, assuming—

General DOLVIN. Yes; it would be very difficult to put it in other than at the end.

As a matter of practice, as you phase the Americans down, there would be fewer schools and you would probably transfer some of it during the life of the treaty.

Mr. NONNENMACHER. I do not know if you were here when Congressman Snyder made his opening statement, but he indicated he would like to get some of the answers to the unanswered questions back on August 17 when the treaty had not been published.

While he intended to put the questions to Ambassador Linowitz, time ran out. Since you represent the Joint Chiefs and the Secretary, I would like to ask one of those questions.

First of all, let me state how it was put back on the 17th of August to Mr. Linowitz. Mr. Snyder said, "Well, does the neutrality that you refer to in your statement today mean that warships of an enemy at war with the United States could pass through the Canal?"

Mr. Linowitz answered, "Again, you are getting into specific provisions of the treaty which will have to wait until the treaty is ready."

Well, General, now that the treaty has been published and we have all read it, I would like to ask for Mr. Snyder that question so that you can answer it.

Does the neutrality referred to in the treaties mean that warships of an enemy at war with the United States could pass through the canal? Would we have to guarantee that?

General DOLVIN. The neutrality treaty provides for the warships of any nation to go through the canal in times of peace or war. I might amplify it, however, to explain why the Joint Chiefs don't worry about this provision very much. We do not think the enemy ship could ever get there, and if they did get there, we do not think they could get away. In other words, we would prefer to have it neutral and available to everybody and depend upon our ability to deny the entrance and exit of the canal to hostiles.

I might add that it is in the exact same situation as it is today.

To answer your question precisely, they would have a right if they get there.

Mr. NONNENMACHER. I appreciate the candor with which you answered the question.

I do not know why that question could not have been answered at that earlier date.

Relative to another unanswered question, could you add anything to what Ambassador Linowitz stated as to what we can do if the threat to the canal came from the Panamanian sources, whether dissidents, terrorists, or the Government in power in the event that occurred? General Torrijos' statement was that we are not to intervene in Panama's internal affairs.

General DOLVIN. I really would not like to say what we would do. I would be happy to clarify again how the Joint Chiefs feel about this. They think the treaty as written and certainly as clarified, gives us a right to take whatever steps we deem necessary to maintain the neutrality of the canal, no matter what that threat might be.

However, we prefer to keep the options open because it is difficult to know what you might want to do beyond the year 2000. I think you are asking for a precise answer to a situation that is not known.

Mr. NONNENMACHER. Not quite. The question is meant only after the year 2000 when we no longer have a presence there, and Panama has total control, and in the precise situation where Panamanians, whether the legitimate regime or dissidents with enough power to do so, pose this threat.

General DOLVIN. Again, I think the Treaty gives us the right to maintain the neutrality of the Canal no matter where the threat comes from. What it doesn't give us is the right to interfere in the internal affairs of Panama. We look after the canal and not the internal affairs of Panama. Precisely what steps we would take should be left to the time when that situation arises.

Mr. NONNENMACHER. Then it is fair for Members of Congress to conclude that what you are saying is that we have a right to intervene to take the action necessary to keep the canal open even if Panama itself or a dissident Panamanian force is the aggressor?

General DOLVIN. I did not use the word "intervene," if you will recall. I said we have the right under the Treaty to take whatever steps we deem necessary to maintain the neutrality of the canal, irrespective of the threat source.

Mr. NONNENMACHER. With that clarification you just put on it, I say thank you. I think that answers the question.

Thank you, Mr. Chairman.

Mr. METCALFE. Mr. Tannenbaum, do you have some questions?

Mr. TANNENBAUM. Yes, thank you, Mr. Chairman.

Is it possible for you to translate the 352.9 in military assets which will be turned over to Panama during the life of the treaty in terms of present day dollars?

General DOLVIN. I have no way of doing that. I suppose that there are people who could estimate that. The military does not, as you know, depreciate their facilities.

Mr. TANNENBAUM. You would have a replacement value?

General DOLVIN. The 352.9 million figure is all that we have. It has been worked out from available records.

Mr. TANNENBAUM. You state on page 2 that under the new treaties, a portion of the proceeds from the transit of our warships will be



provided to Panama. Funds for these tolls will come from the operating budget of the user service.

Do you have an estimate of what the additional cost to the United States will be for the transit of United States military vessels?

General DOLVIN. That depends, Mr. Tannenbaum, as you know on the traffic. I don't have that figure. It would vary every year. It depends on how many ships go through. If you were thinking in terms of the Vietnam war years, it would be one thing and last year it would be another. We could probably provide that information for you.

Mr. TANNENBAUM. Could you find those figures based upon the years you mentioned?

General DOLVIN. Say 1975 or some given year?

Mr. TANNENBAUM. Up through the present time, the projected increase, assuming that the traffic were similar in the future. Could you do that?

General DOLVIN. Yes, I will provide that.

Mr. TANNENBAUM. Thank you.

Mr. METCALFE. If there are no further questions, we thank you.

General DOLVIN. Thank you.

Mr. METCALFE. We appreciate your testimony.

[The following was provided for the record:]

#### NAVY AND GOVERNMENT TOLLS

Under the present system, U.S. Navy and other U.S. Government ships do not pay direct tolls. The toll charges, however, are computed and the amounts are used by the Panama Canal Company to offset its obligation to reimburse the U.S. Treasury. Naval toll credits for 1976 amounted to approximately \$95,036, and \$75,050 for the year 1977. These credits do not include MSC vessels or other U.S. Government shipping. Under the terms of the new Panama Canal Treaty, tolls will be paid directly to the Panama Canal Commission.

Mr. METCALFE. Our next witness is Mr. Arnold Nachmanoff, Deputy Assistant Secretary of Treasury for Developing Nations, Treasury Department.

I believe Mr. Nachmanoff participated in negotiations that developed the package of loans and grants that is outside the treaty.

Additionally, our witness will be presenting us with information as to how the U.S. Treasury will relate to the proposed Panama Canal Commission.

[Questions posed by the subcommittee and responses provided by the witness prior to the hearing follow:]

#### QUESTION POSED TO TREASURY DEPARTMENT

1. List in detail all economic benefits to Panama provided by the treaties and understandings and agreements pursuant to the treaties with—

- (a) the dollar amount or dollar equivalent;
  - (b) wherever applicable, the exact source of the funds to be used for payment of such benefits; and
  - (c) the beneficiaries (governmental or private) of the benefits.
- Included in this listing should be:
- (a) Direct payments under Articles III and XIII of the treaty;
  - (b) Transfers of U.S. assets of all real and personal property, including military assets;
  - (c) Transfers of operating revenue-producing business activities (as offset by transfers of operating revenue-losing business activities);
  - (d) Loans to Panama by EXIM Bank and other U.S. or international lending institutions; and

(e) Technical and management assistance mandated in the treaty and related documents.

2. List the U.S. costs and benefits associated with the treaties, including:

(a) Any prospective increase or decrease in Treasury receipts associated with the terms of the Canal treaties;

(b) Changes in the assets of the U.S. government;

(c) Prospective increases or decreases in appropriations required for U.S. activities now in the Canal Zone;

(d) Decrease in users' surplus value of Canal to U.S. users if tolls increases are effectuated; and

(e) Monies to carry out obligations in connection with employee provisions of the treaties.

3. The note of Secretary Vance to Panamanian Ambassador Lewis's unilaterally commits the United States to certain economic and military cooperation with the Republic of Panama. From the viewpoint of the Executive, how is implementation of this commitment related (if at all) to ratification and implementation of the proposed treaties? How does this commitment to Panama relate to U.S. economic and security interests in the Canal?

4. Under the present U.S. structure to govern the Panama Canal, the United States Treasury has a set of specific relationships with the Canal enterprise:

(a) Company cash assets exceeding current operating requirements are deposited in the Treasury;

(b) An annual interest payment on the net direct investment of the U.S. Government in the Panama Canal Company is made to the Treasury;

(c) The Canal Company is empowered to borrow from the U.S. Treasury a total not to exceed \$40 million;

(d) Pursuant to an appropriations enactment, financing for various Canal Zone Government expenses is made by the Treasury. These monies are repaid to the U.S. Treasury by deposits of revenues for Canal Zone Government services and by the Panama Canal Company revenues which are reimbursements for the net cost of the Canal Zone Government;

(e) Dividends of the Panama Canal Company in excess of capital requirements and plant replacements are paid into the Treasury;

(f) Repayment by the Company to the Treasury is made for appropriations to cover losses sustained by the Company;

(g) The amount of U.S. investment in the Canal Company is increased for funds advanced to the Panama Canal Company from the Treasury within such appropriations as Congress may make for capital needs, and also for transfers of assets from other government agencies;

(h) Tolls computed on government vessels which transit the Canal are offset against Company obligations to the Treasury.

Under the proposed treaties, what changes are necessary or do you recommend for each of the transactional relationships now in effect?

5. Under the proposed Panama Canal Treaty, the Panama Canal Commission will be a U.S. Government agency, but the Treaty also provides that the Canal will be turned over to Panama by the year 2000 "in operating condition and free of liens and debts". In light of these and other provisions of the proposed treaty package, what should be done with respect to the unrecovered investment of the United States in the Canal and the net direct investment of the U.S. Government in the Panama Canal Company? Should these be written off when the new Treaty goes into effect, or at the termination of the Treaty, as a cost of foreign policy? Should the amounts be repaid?

6. Under the proposed Treaty and accompanying documents, numerous financial transactions between the U.S., the Commission and Panama are mandated, including, for example, provision of certain utility services to Panama by the Commission with reimbursement by Panama at a later time. If the U.S. Treasury is to be the depository of Commission funds, is there any reason why payments to Panama under Articles III and XIII of the Treaty could not be offset by amounts Panama owes to the Commission and the United States? In what time and manner should each of the payments to Panama under Articles III and XIII be made? (For example, should the payment to Panama of \$.30 per Panama Canal net ton be made annually in one lump sum or as Canal traffic accrues?)



STATEMENT OF ARNOLD NACHMANOFF, DEPUTY ASSISTANT SECRETARY OF TREASURY FOR DEVELOPING NATIONS, TREASURY DEPARTMENT

Mr. NACHMANOFF. I am pleased to be here today to testify before the subcommittee on some of the economic and financial benefits the United States and Panama will derive from the Panama Canal Treaty and the economic cooperation arrangements associated with the treaty.

The subcommittee has provided the Treasury with a list of questions that it wishes answered for the record. I have provided a written response for those questions which Treasury is qualified to answer, given its limited role in the negotiations.

Other agencies will address questions not within the purview of the Treasury. In this connection, I wish to note that Treasury did not participate directly in the treaty negotiations. Its contribution was to recommend economic cooperation arrangements, and to provide advice on the financial arrangements for the new Panama Canal Commission. On issues not related to these two areas, I will therefore defer to the expertise of the other administration witnesses.

I would like to address the subject of benefits—both for the United States and Panama—from a broad perspective to supplement the more detailed information provided by other administration witnesses on this subject.

The Treasury believes that the treaties will have a beneficial effect, not only for the United States and Panama, but for the entire world trading community. The shipping industry and those whom it serves have a continuing interest in preventing abrupt or arbitrary closure of the canal. A cooperative relationship between Panama and the United States established by the new treaties should maximize the prospects for its safe, uninterrupted and efficient operation. Absence of a new treaty and that relationship creates an element of uncertainty and instability in the canal environment. Once the new treaties are ratified and implemented, the prospect of interruptions to the operations of the canal will be significantly reduced.

Since 1974 the Panamanian economy experienced a protracted slowdown, with growth rates declining from an average of 7.3 percent in the prior decade to 2.6 percent in 1974, 1.7 percent in 1975 and no growth in 1976. Although a number of factors contributed to this slowdown, a major contributing cause was a marked decrease in private investment as a result of uncertainty over the future of the canal.

The Government of Panama attempted to compensate for the decline in private investment by increasing public investment. This policy, however, resulted in an increase in the central Government budget deficit from \$69 million in 1973 to \$122 million in 1976. The need to finance this deficit, as well as Panama's current account deficits, caused total public sector debt to rise from \$600 million in 1973 to \$1.4 billion in 1976.

Yet, despite these troubling developments, there is reason for cautious optimism about the future of Panama's economy. Panama has negotiated two stabilization agreements with the International Monetary Fund and has taken steps to reduce the Government deficit and limit public sector debt. Sustained world economic recovery should

help to stimulate demand for Panamanian exports and thereby narrow Panama's current account deficit.

From an economic perspective, the treaty helps to assure that Panama will be a viable treaty partner and provides Panama with a vital stake in the successful operation of the canal. While not a panacea for Panama's economic difficulties, these arrangements will provide a much-needed extra boost that will facilitate Panama's long-term economic development.

More important to Panama's economy, settlement of the longstanding canal issue by ratification of the treaties should markedly improve the investment climate in Panama. We expect foreign and domestic private investment in Panama to rise appreciably, leading to increased employment, reduced budgetary pressure on the Government of Panama, and improvement in Panama's external accounts. This is important to the United States inasmuch as greater economic stability and an improved standard of living in Panama will reinforce Panama's ability to act as our partner in the canal enterprise.

The proposed economic cooperation arrangements, which were described by Ambassador Linowitz, are also being undertaken in the same spirit of mutual benefit. Whereas the benefits that Panama will receive from these economic cooperation arrangements are readily apparent, there are also benefits for the United States.

One corollary of Panama's economic development will be increased opportunities for U.S. businessmen and investors in Panama's free enterprise economy. The plans for Eximbank and OPIC programs in Panama will help U.S. businessmen take advantage of these opportunities. In addition, it can be expected that Panama's economic development will result in its becoming an expanding market for U.S. exporters, who now meet 40 percent of Panama's nonoil import needs. This projected market expansion is expected to give rise to more applications for Eximbank support, and Eximbank has indicated that its business could well amount to more than \$200 million over the next 5 years. This will mean more jobs and exports for the U.S. economy and be achieved with no added burden to the taxpayer since the Exim program will be financed under existing authorizations.

Mr. METCALFE. May I interrupt you.

Let the committee stand in recess. Mr. Hubbard will be here in a moment to continue, so the committee will stand in recess for a short period.

[Brief recess.]

Mr. HUBBARD [presiding]. The Subcommittee on the Panama Canal will go back into session. We will ask the witness, Mr. Nachmanoff, to go ahead please and resume his testimony.

Mr. NACHMANOFF. Thank you, sir.

All of the components of the economic arrangements present a reasonable level of risk, and will not jeopardize the continued successful operation of the programs involved. Each of the institutions will subject proposed loans and guarantees to its standard rules and most importantly will assure that prospective borrowers are "creditworthy."

That portfolio risk to Eximbank as a result of its offer, for example, will be small. With an additional \$200 million to Panama for 5 years, exposure in Panama will amount to less than 1.37 percent of Eximbank's total existing portfolio. Project risk will be controlled in the



usual manner, since each transaction will be subject to normal Eximbank financial, legal, and engineering criteria—including Eximbank's statutory requirement to find a reasonable assurance of repayment.

As for the Overseas Private Investment Corporation, its guarantee of \$20 million in borrowing by the Panamanian Development Bank would raise OPIC's exposure in Panama to only 8.5 percent of its total existing portfolio, a reasonable level of portfolio risk. The risk to OPIC will be further reduced by a Government of Panama guarantee. OPIC has also stipulated that its offer to Panama depends on terms being negotiated which are acceptable to the OPIC Board.

This will be the first time OPIC has participated in financing the expansion of a Government-owned development bank, although OPIC is permitted to do so by longstanding OPIC Board policy guidelines. The Panamanian development bank, COFINA, is engaged in supporting the development of small to medium size private enterprises in Panama through project lending. This function is both wholly compatible with OPIC's mission and in accord with our view that it should help strengthen the private sector of Panama's economy.

A final point that should be noted about the economic cooperation arrangements is that they will not increase the burden of the U.S. taxpayer, as any loans contained in these arrangements will be non-concessional, thus assuring that there will be no indirect subsidy to the borrowers. Also, much of the proposed assistance is in the form of guarantees, which only obligate agencies of the U.S. Government in the unlikely event of default. Even if default should occur, all three agencies maintain self-financed reserves against which the defaults are charged, thereby insulating the taxpayer from any direct cost.

At this point, I would like to turn to a second major issue about which the subcommittee has indicated its concern: the net effect of the financial aspects of the treaties on the Treasury's receipts. Specifically, the subcommittee has requested that Treasury compare its existing financial transactions with the Panama Canal Company to the new financial relationship that will exist with the Panama Canal Commission. As requested, a detailed statement to this effect has been submitted for the record. However, I would like to make a few general observations about the effect of the canal treaties on Treasury receipts.

At present, the combined operations of the Panama Canal Company and the Canal Zone Government are basically self-financing. Revenues from Company operations and from certain Government activities generally cover expenses of both the Company and the Government. Indeed, in the period 1903 to the end of the transition quarter, 1976, the Treasury has recovered virtually all of the \$1.9 billion of total outlays during this period. The net impact of present arrangements on Treasury thus depends on whether revenues from total canal operations exceed expenses.

Under the new treaty arrangements, the net impact of the canal operations will also depend on whether revenues cover expenses. The new Panama Canal Commission is designed to be self-sustaining; and based on the best information available to Treasury and the negotiators, it is anticipated that total revenues from the new canal operation will be sufficient to cover all expenses.

With regard to the committee's inquiry on interest payments, the administration will seek repeal of that requirement in the implement-

ing legislation. This decision emanated from the negotiators' effort to balance three policy objectives:

One. To keep the Commission self-sustaining;

Two. To avoid an uneconomic increase in tolls; and

Three. To help assure Panama's stake in the efficient operation of the canal by providing Panama with an equitable share of the benefits.

To reconcile these goals, the negotiators determined that it was necessary for national policy reasons for the U.S. Government to forego the receipt of interest. This does not mean, however, that Treasury will forego receipts from the Commission if earnings permit dividends to be paid.

Mr. Chairman, this concludes my formal statement. I will be happy to try to answer any questions the committee may have.

Mr. HUBBARD. Thank you very much.

You say that if the Republic of Panama's economy is improved, that country could be a better partner for the United States at the canal.

Could you be more specific and tell us exactly how the level of U.S. investment in Panama and the state of its economy do affect canal operations?

Mr. NACHMANOFF. Yes, sir. The canal exists in the environment of the Panamanian society and economy. To the extent that economic development occurs, that will tend to promote stability in the environment around the canal and generally be helpful.

Second, to the extent that the Panamanian economy develops, and its resources are developed, Panama's ability to carry out its functions as a partner with us—in gradually increasing its role in the operation of the canal, in the management of the canal, and in the defense of the canal—will be enhanced.

Mr. HUBBARD. Second, has Panama ever defaulted on any of its international financial obligations?

Mr. NACHMANOFF. No, sir. I do not believe Panama has defaulted on any of its international obligations. There are a few obligations that are under dispute. They are relatively minor and under discussion at the present time.

Mr. HUBBARD. If Panama did default, especially on the agreements associated with the treaty, what would be the consequences?

Mr. NACHMANOFF. Well, I assume the question refers to default on debts or obligations under the treaty.

Mr. HUBBARD. Yes, sir, debts and obligations.

Mr. NACHMANOFF. To the best of my knowledge, there are no debts or obligations of a financial character which Panama assumes under the new treaty.

Perhaps the question refers to the economic cooperative arrangements which are independent of the treaty. Panama has not defaulted on comparable obligations to date. We would not expect that they would in the future.

The consequences of a default on obligations would be the same as for any other country and there would have to be a settlement.

Let me say that I do not think it would be in Panama's interest under any circumstances to default on its international obligations.

Panama is becoming and seeks to become an international banking center. I believe Mr. Cooper from the State Department described that this morning and it would not be in Panama's interest to default.



Mr. Chairman, I might point out also in the case of the Export-Import Bank, the loans may not be to the Government of Panama, but to private borrowers.

Mr. HUBBARD. Thank you.

In the last answer in the answers provided to subcommittee questions, you indicate that the practice of indirectly subsidizing Government agencies for nonpayment of tolls should end, but indirectly subsidizing canal users by dropping the investment payment should now begin.

Can you explain this paradoxical situation in which we end one subsidy and begin another?

Mr. NACHMANOFF. The provision I believe you are referring to is the proposed requirement that the new Canal Commission will require that the U.S. Government vessels pay tolls to the Commission.

At the present time, U.S. vessels do not pay tolls, but the amount that those tolls would have produced is credited against payments to Treasury by the present Panama Canal Company and, in effect, the Treasury is subsidizing the activities of other agencies of the Government.

What will happen under the proposed arrangement is that the tolls will be paid to the Commission. The Commission will therefore have additional revenues to meet its obligations and perhaps result in surpluses. Should there be surpluses they might permit dividends to be paid to the Treasury.

I am not sure what the other provision you are referring to was, Mr. Chairman. I wonder if you might clarify the other aspect of the question.

Mr. HUBBARD. We are talking about the investment payment of \$20 million per year to the Panama Canal Company. If we drop this investment payment, are we not indirectly subsidizing canal users?

Mr. NACHMANOFF. I understand the question now, sir.

This is the interest payment on the net direct investment that is currently required which we propose be dropped. One reason that payment was required in 1951 when the Canal Company was established as a self-sustaining business enterprise was to avoid allowing the users to have a subsidized toll or excessively subsidized toll; that is by requiring that the cost of capital be included in the toll base. That requirement will no longer be necessary because under the new arrangements, the toll will increase in order to meet the costs and requirements under the new treaty arrangements. Thus the tolls will approach a more economic level and a need for interest payment as a device in effect to avoid subsidy will no longer be necessary.

Mr. HUBBARD. I will recognize minority counsel for questions at this time, please.

Mr. NONNENMACHER. Thank you, Mr. Hubbard. Mr. Staats testified that he understood the administration proposes to relieve the new Commission of the obligation to pay interest to the Treasury. You verified this when you stated that the administration will indeed do that. You state the three reasons and three points that were meant to be put in balance by that decision, the second of which was to avoid an uneconomic increase in tolls.

However, I think Mr. Staats went on to make a critical point, and I will read what he said:

This proposal would improve the cash position of the new Commission.

That is about what you say.

This proposal would improve the cash position of the new Commission and relieve some of the upward pressure of costs on toll rates, but it would also reduce Treasury receipts and impact on the overall U.S. budget.

Mr. Linowitz has told us again and again none of this treaty is going to cost the American taxpayer anything. Yet, here we see a \$20 million figure at least—\$20 million will not be going into the Treasury.

Do you foresee any effort on the part of the Treasury to make up for that from the American taxpayer?

Mr. NACHMANOFF. There will be a reduction in receipts as a result of the fact interest will be foregone. On the other hand, the Canal Commission will be obligated to pay dividends if earnings permit. It is difficult at this stage to know what the net effect would be, it would depend on the extent to which the dividends might exceed the foregone interest.

Mr. NONNENMACHER. May I ask which has priority? Those dividends or that extra contingent \$10 million to Panama?

Mr. NACHMANOFF. The extra contingent \$10 million would have priority under the treaty arrangements.

Mr. NONNENMACHER. I think it is fair to conclude from our observation point up here that that extra \$10 million was not expected to be very likely, so the return of dividends to the Treasury would be even less likely.

Is that a fair statement?

Mr. NACHMANOFF. I think it is very difficult to know at this point just what the earnings might be and what the level of dividends might be at any given time. I would say on the whole the probability is that the net effect would be that the dividends are likely to be less than the interest foregone. But I do not think anyone can project ahead very clearly over the period of the treaty.

Mr. NONNENMACHER. In view of the fact that you wanted to avoid an uneconomic increase in the tolls that interest payments would require, it is not likely there'll be support for such a heightened toll to pay dividends, is it? In other words, it probably rests in the same area, that there would be no effort to gain those dividends to make up for the interest payments because you would end up having to raise the tolls anyway. And so, you might as well have taken the interest levels in the first place.

Mr. NACHMANOFF. The tolls would be one determinant and the volume of traffic would be another. That is the determinant we cannot predict with great accuracy at this point. A third determinant would be the cost of operating the canal.

Mr. NONNENMACHER. Let me go on with another question.

On page 3 of your testimony, you gave the net deficit figure or the total public sector debt of Panama as \$1.4 billion in 1976.

This morning in questions to Mr. Linowitz, Mr. Snyder got the response that \$648 million was the amount owed to commercial banks, of which \$355 million was owed to the U.S. private commercial banks.

Do those figures square with you figures?

Mr. NACHMANOFF. That is correct.

Mr. NONNENMACHER. Then where is the remainder of this \$1.4 billion?

Is that debt to the Export-Import Bank, World Bank, or other multinational or multilateral agencies?



Mr. NACHIMANOFF. \$1.4 billion is total public sector.

Total disbursed debt is \$1.1 billion. The remainder, that is the difference between the \$648 million and the \$1.4 billion, would be owed to other governments, to international institutions and so forth.

Mr. NONNENMACHER. That is money that Panama has not yet received, is that correct?

Mr. NACHIMANOFF. No. That money is the difference between the \$1.4 billion and \$1.1 billion. Committed but undisbursed.

Mr. NONNENMACHER. From the creditor sources?

Mr. NACHIMANOFF. Correct.

Mr. NONNENMACHER. Whatever they may be?

Mr. NACHIMANOFF. Correct.

Mr. NONNENMACHER. I have a question regarding Cofina. You mentioned Cofina on page 6, Panama Development Bank.

Mr. NACHIMANOFF. Yes, sir.

Mr. NONNENMACHER. You state:

"The Panamanian Development Bank, Cofina, is engaged in supporting the development of small to medium private enterprises in Panama through project lending."

As Mr. Snyder said in his opening statement, there has been much discussion of the role that the international banks may have played in the role of this Panama Canal Treaty.

In the Congressman's statement, he quoted extensively from Senator Church's report on "International Debt, the Banks, and United States Foreign Policy."

Would you be able to contribute anything in this discussion as to what role the international banks have played and are playing in Panama's development?

Could you tell us: Are the commercial banks in deep trouble insofar as repayment, first, of interest; second, of principal; and third, is the turning over of the Panama Canal and the zone surrounding it to the Government of Panama expected to benefit the lenders, the creditors, the international banks, or other agencies who have lent their money to Panama?

I would appreciate your comments in this area.

Mr. NACHIMANOFF. Well, first as to the role of the banks in Panama's economy, the banking sector, as I mentioned, is an important service sector in Panama.

The banks' exposure in Panama itself is about \$400 million of which about \$355 million is exposure in terms of public sector entities.

As I mentioned in my testimony, the Government of Panama has sought to maintain public investments during a period when private investments have slowed down, in part as a result of the global economic situation, but in major part because of the uncertainties over the canal enterprise. So the private banks have been an important source of lending and financing which have allowed the Panamanian public sector to maintain its investment programs.

Now, as to the question of exposure and risks, the studies we have seen suggest that there are no United States banks which have an exposure in excess of the regulating agencies' requirements.

Panama has not defaulted on any of its debts and I believe they are manageable.

Panama's debt service is fairly substantial at the present time, but it is maintaining its commitments.

Now, the results of a new treaty arrangement would be beneficial to the Panamanian economy, not only in terms of the revenues that the Panama Government would receive, which would certainly help their financial position, but also in terms of the general climate for investment and capital flows.

This would undoubtedly improve their creditworthiness.

I might say, however, that at no time was it considered in the negotiations, or in positions taken within the Government, that the economic benefits that Panama would derive from the treaty would be designed in any way to meet Panama's debt service needs. To the extent that the results will be helpful to Panama, that is indeed coincidental. But the benefits to Panama will be substantial. Its financial position will improve as a result of the treaty arrangements and its borrowing capacity and ability to service debts will improve.

Mr. NONNENMACHER. You say Panama has not defaulted. Has it paid off any principal on these loans or has it all been interest to date?

Mr. NACHMANOFF. I do not have any information on that.

Mr. NONNENMACHER. Would you supply it for the subcommittee?

Mr. NACHMANOFF. Yes; I will try to supply it for the record. They paid back Government debts in terms of principal as well as interest.

Mr. NONNENMACHER. To commercial banks?

Mr. NACHMANOFF. No, to the U.S. Government agencies. I do not know what the situation is at the present time with regard to commercial borrowings, what the terms are.

Mr. NONNENMACHER. I would appreciate it if you would submit it to us.

Mr. NACHMANOFF. Certainly.

[The following was supplied for the record:]

Yes. We are not aware of any arrearages on bank loans to Panama.

Mr. NONNENMACHER. Does COFINA restrict itself to lending inside Panama or does it lend outside the Republic of Panama?

Mr. NACHMANOFF. My assumption, based on the information I have, is that it lends only within Panama to entities that would be Panamanian; it would be within the Panamanian economy.

[The following was received for the record:]

COFINA's policy as an instrument for promoting economic development within Panama is to restrict its lending to Panama.

Mr. NONNENMACHER. Would you be good enough to determine whether or not it indeed may and does, in fact, lend money outside the limits of the republic?

Mr. NACHMANOFF. We will try to determine that.

Mr. NONNENMACHER. As a followup, would you determine—it may not be possible—but would you determine for us what you can find out regarding Panama's commercial bank lending outside of Panama, especially in regard to funds they have received from the international banks in the first place? I would be very interested if you could come up with anything in that direction. If you follow me, say that money was lent to an internal company and it, in turn, loaned money to companies outside Panama's border.



Mr. NACHMANOFF. Yes; I can.

[The following was submitted for the record:]

#### PANAMANIAN BANKS

Detailed information on the operations of Panamanian owned banks is not available, so we cannot provide data on their foreign lending operations. However, statistics on all banks operating out of Panama show that, as of end-December, 1976, external liabilities of banks in Panama amounted to nearly \$8.6 billion while their external assets totalled almost \$7.8 billion. That is, over 90% of the foreign funds obtained by banks operating in Panama were apparently lent to foreigners (borrowers outside of Panama.)

Mr. NACHMANOFF. The total claims of U.S. banks on Panama as of June 30, 1977, were about \$2.9 billion, of which about——

Mr. NONNENMACHER. Million or billion?

Mr. NACHMANOFF. Billion.

Mr. NONNENMACHER. Billion?

Mr. NACHMANOFF. Yes, of which about \$2.5 billion was on-lent to borrowers in other countries.

Mr. NONNENMACHER. Would you repeat that please?

Mr. NACHMANOFF. The total claims of U.S. banks on Panama as of June 30, 1977——

Mr. NONNENMACHER. You mean Panama or Panama banks? Is this the Republic itself that you are talking about?

Mr. NACHMANOFF. No. No, it is in Panama.

Mr. NONNENMACHER. Private and public?

Mr. NACHMANOFF. Yes. \$2.9 billion, of which \$2.5 billion approximately is on-lent to other countries.

This simply reflects the fact that Panama has become an international banking center.

Mr. NONNENMACHER. I see.

In other words all that money has not been going into developing Panama itself, but indeed the vast bulk of it has gone to other countries?

Mr. NACHMANOFF. That is right. Panama benefits from the provision of the banking services; that is, the jobs and earnings provided by that service function.

Mr. NONNENMACHER. But is not one thing clear, that once this money which goes from the U.S. banks to Panama banks and then goes overseas elsewhere, it is no longer a concern or under the control of any U.S. banking authority or agencies and the power of inspection; is that not true?

Mr. NACHMANOFF. No; that is not so, sir.

Any loans by U.S. banks or their branches do fall under the regulatory authorities.

Mr. NONNENMACHER. That is right, but the money that is in turn on-lent, once the Panama banks receive those loans, that money at that point is no longer under the scrutiny of the American authorities; is that right?

Mr. NACHMANOFF. Let me clarify that. It is not necessarily that that money goes through Panamanian banks. It goes through branches of U.S. banks which may have been located in Panama and, as such, fall under the regulatory authority of the Comptroller of the Currency.

Mr. NONNENMACHER. That raises the question of Panama as a bank haven, and that leads me to a question that has concerned a number of us on the staff.

What advantage does Panama offer as a bank haven that the Bahamas, Nassau, or Caymans do not offer?

Why does Panama seem more advantageous to U.S. banks?

Mr. NACHMANOFF. I would like to take that question back and reply to it for the record if I may.

Mr. NONNENMACHER. I would appreciate that very much.

[The following was supplied for the record:]

#### ADVANTAGES OF PANAMANIAN BANKS

Panama's historical role as a commercial crossroads, the use of the U.S. dollar as the circulating medium of exchange, the absence of exchange controls, the availability of an adequately educated, bilingual labor force, and relatively easy immigration of multinational corporation employees are factors which banks may consider in determining branch location.

Mr. NONNENMACHER. I have only two other questions.

You mentioned that OPIC's exposure in Panama would be raised to only 8.5 percent of its total existing portfolio, a reasonable level of portfolio risk.

Is that "reasonable," matched against the entire world where OPIC plays a role in U.S. investment? Only 8.5 percent would be concentrated in Panama? That seems to be quite a high figure.

Mr. NACHMANOFF. They are designed primarily for the developing nations and concentrate on the lower income developing nations and, therefore, when looked at within a narrower universe of potential countries, that does not seem to us to be an unreasonable level of exposure for Panama.

I might note also, as I mentioned in my testimony, that that exposure is guaranteed by the Government of Panama as well, which reduces the risk factor.

Mr. NONNENMACHER. Have you had any contact with the American international banks regarding the treaty, either before or after its publication, especially insofar as the special concerns they might have?

Mr. NACHMANOFF. No, sir.

Mr. NONNENMACHER. Thank you very much.

I appreciate the clarity of your statement and the clarity of your answers to most of my questions.

I thank you, Mr. Hubbard.

Mr. HUBBARD. Thank you.

Mr. Tannenbaum, do you have any questions?

Mr. TANNENBAUM. Yes, thank you.

There was one thing I did not understand in response to the question just posed; \$2.5 billion of the \$2.9 billion representing total claims of U.S. banks in Panama goes to other countries.

What is the advantage to U.S. banks in transferring these funds through Panama as distinguished from making direct payments to the other countries.

Mr. NACHMANOFF. I would prefer to try to respond to that for the record, sir.

Mr. TANNENBAUM. Are there tax losses to the U.S. Treasury?



Mr. NACHMANOFF. We would have to take a look at that.

Mr. TANNENBAUM. I thank you.

[The following was supplied for the record:]

#### ATTRACTIVENESS OF OFFSHORE BANKING CENTERS

The attractiveness of offshore banking centers stems partially from low tax rates; but other factors are probably of equal or greater importance. Access to other banks, favorable banking regulations, banking secrecy legislation, free movement of capital and perceived stability of the business environment are additional factors which banks may consider in selection of office location.

If the banks operated through Panamanian subsidiaries, they would clearly gain a tax advantage, since they would not be liable to U.S. tax on profits not remitted to the United States. But in fact U.S. firms conduct most of their banking operations in Panama through branches rather than subsidiaries. U.S. corporations are taxed currently on the profits of their foreign branches, to the extent that they are not offset by U.S. tax credits for taxes paid to foreign governments. If they operate in high tax countries, there is an advantage in also operating in some low tax countries to average the foreign tax rates; but the final tax will be the higher of the U.S. or foreign taxes.

Mr. TANNENBAUM. On page 1 of your statement you refer to the fact that the Treasury made certain economic cooperation arrangements.

Can you provide for the subcommittee the substance of these recommendations and particularly have these recommendations been fully accepted in the conference within the treaty documents?

Mr. NACHMANOFF. Let me note again that the economic cooperation arrangements are totally outside of the treaty package and are reflected in the letter from Secretary Vance to Ambassador Lewis.

As a statement of intent, they are not legally binding commitments and, in effect, what the statement says is that the United States will make a best effort to provide assistance through these established programs to the levels discussed in the Vance letter.

Now, it should be noted that these are agencies which already have programs operating in Panama under existing authority. They have the authority to expand those programs. They may do so, but they will do so on a case-by-case basis, reviewing each transaction to assure that it complies with the requirements, regulations and policies that those institutions have for their programs.

Our involvement in the formulation of the economic cooperation arrangements was to help find the kind of programs that would be appropriate to Panama's development needs and consistent with its status. These are all nonconcessional programs. They all fall within existing authorities. None of them would require appropriations to carry out.

I would say generally that the proposal that you have before you is consistent with the Treasury Department's recommendations.

Mr. TANNENBAUM. Would the same be true of the advice provided by the Treasury on the financial arrangements for the new Panama Canal Commission?

In other words, the Treasury suggests that at the end of the treaty we turn over our assets free and clear of all obligations; that we wipe out all obligations.

Mr. NACHMANOFF. The Treasury did not participate directly in the negotiations.

Let me repeat what Mr. Cooper said this morning. It really is not appropriate to look at this in financial terms. The whole treaty arrangement relates to our national policy or objectives and, in effect, is in exchange involving various elements, including financial elements, in order to best serve our national interests which lie in an open and efficient operation of the canal.

It is the administration's judgment that the best way to achieve that is through a cooperative arrangement with Panama rather than through confrontation. The treaty negotiators determined the elements of what would be required to achieve that kind of cooperative arrangement.

The Treasury did help in discussing some of the elements of the financial arrangement. In particular, the element of the second \$10 million which is contingent upon earnings, was suggested by the Treasury Department as a way to provide a bit of a cushion for the Commission which will have a self-sustaining character. That is to say, that payment is not required unless there is a surplus of earnings.

Mr. TANNENBAUM. The question I am trying to pose here is, were these Treasury recommendations followed or was it the opposite? Was it that the administration told the Treasury Department how to accomplish it? In other words, was this package initiated by or recommended by the Treasury?

Mr. NACHMANOFF. The Treasury did not initiate the financial arrangements in the treaty package.

We did have a role in the economic cooperation arrangements that were separate from the treaty. We were asked to comment and did offer suggestions on effects of the financial arrangements. As you can well appreciate, the formulation of such a policy is not determined by any one agency. It involves an interagency process and, ultimately, the decision was made by the President of the United States as to what he is prepared to see as part of a new treaty arrangement toward the achievement of our national objectives.

Mr. TANNENBAUM. Excuse me, but I really do not get the feeling that you responded to the question as to whether the Treasury's recommendations and advice were essentially followed, or did the Treasury not make some recommendations or render such advice as rendered in your statement which should be answered to?

Mr. NACHMANOFF. I think you are asking a very specific question about internal policy recommendations within the executive branch, and they occur at various levels and various degrees of definitiveness.

As I said, we were asked and we did offer comments and suggestions. The results of the financial package are not inconsistent with the views of the Treasury, but the basic objectives to be served are not financial. They are national defense. They relate to the benefits to the world economy, U.S. economy, and there are foreign policy benefits. They involve judgments the Treasury cannot make in isolation.

Mr. TANNENBAUM. Well, we will pass the whole question then.

What do you envisage would be the impact on Panama in the event that the collateral economic package, the package collateral to the treaties, is not approved?

Mr. NACHMANOFF. Perhaps I should clarify the economic cooperation arrangements package again. This is outside the treaty, and it is a statement of intent.



Mr. TANNENBAUM. We understand that. What would be the effect on Panama if that package were not consummated?

Mr. NACHMANOFF. I suspect the Panamanian Government would be disappointed. It might slow down its ability to carry out its development plans to some extent.

Mr. TANNENBAUM. Do you think Panama would consider it a major breach of faith? I think they would be a lot more disappointed.

Mr. NACHMANOFF. There is no commitment. There is a statement of intent. The statement of intent says these arrangements shall not come into effect until there is an exchange of notes between the two Governments. That has not occurred. I presume this will really have to rest with the State Department. I assume such an exchange of notes will not occur unless there is consultation with the Congress, but I do not know that it is either necessary or intended to submit a formal package for approval. These are all programs that have existing authorizations, they are ongoing programs.

What the statement of intent talks about is possible levels of magnitude over the next 5 years for these ongoing programs.

Mr. TANNENBAUM. In other words, you believe this economic package is a fait accompli?

Mr. NACHMANOFF. No; it is a statement of intent which will depend on a whole variety of circumstances, not the least of which is that Panama must have projects which meet the criteria of the agencies. Similarly, any projects they submit to AID or Exim have to meet the requirements of those agencies, fall within their authorities, and be subject to available funds where appropriate.

Mr. TANNENBAUM. Thank you.

Mr. METCALFE. Thank you very much, Mr. Nachmanoff, for your very fine testimony.

[The following answers were supplied to the subcommittee's questions prior to the hearing:]

#### QUESTIONS AND REPLIES FOR THE RECORD BY THE TREASURY DEPARTMENT

*Question 1.* List in detail all economic benefits to Panama provided by the treaties and understandings and agreements pursuant to the treaties with: (a) the dollar amount or dollar equivalent; (b) wherever applicable, the exact source of the funds to be used for payment of such benefits; and (c) the beneficiaries (governmental or private) of the benefits.

Answer. Panama will receive several different types of economic benefits as a result of various provisions of the treaties and the economic cooperation agreement:

*A. Direct payments under Articles III and XIII of the treaty.*—Article III of the Panama Canal Treaty provides that the Panama Canal Commission will pay the Republic of Panama \$10 million annually for the provision of the following public services in the Canal operating areas: police, fire protection, street maintenance, street lighting, street cleaning, traffic management and garbage collection. Every three years from the date the new treaty enters into force, the cost of providing these services will be reexamined to determine whether adjustment of the annual payment should be made because of inflation and "other relevant factors" affecting the cost of the services.

Article XIII provides that the Republic of Panama will receive 30 cents per Canal ton for traffic transiting the Canal; a fixed annuity of \$10 million per year; and an additional \$10 million per year provided Canal revenues permit. The 30 cent per Canal ton annuity rate will be adjusted for inflation at the end of every two-year period, the first period to begin three years after the treaty takes effect.

Both the service and the annuity payments will be paid from the Panama Canal Commission's operating revenues, and no U.S. government funds will have to be appropriated to meet these payments. More detailed information on the benefits to Panama emanating from Articles III and XIII is being provided by the Department of States.

*B. Transfer of U.S. assets of all real and personal property, including military assets.*—Answers are being provided by the Department of Defense (military assets), the Canal Company (Canal assets), and the Department of State (all other assets).

*C. Transfers of operating revenue-producing business activities (as offset by transfers of operating revenue-losing business activities).*—Answer is being provided by the Panama Canal Company.

*D. Loans to Panama by Eximbank and other U.S. or international lending institutions.*—The proposed economic cooperation arrangements consist of: (1) an offer by the Overseas Private Investment Corporation to guarantee up to \$20 million in borrowings in the U.S. capital market by the Panamanian development bank, (2) an offer by the Export-Import Bank to provide up to \$200 million in loans, loan guarantees and insurance for individual U.S. export sales over a five-year period; and (3) a pledge by the Administration to consider providing up to \$75 million in housing investment guarantees over a five-year period. In addition, DOD will provide up to \$50 million in guarantees over a ten-year period under our Foreign Military Sales program. There are no provisions in the treaties, the economic cooperation arrangements, or elsewhere for any special lending to Panama by the international financial institutions.

We expect that the economic cooperation package will provide mutual benefits to Panama and the U.S. First, the economic cooperation package, by promoting Panama's economic development, will facilitate the creation of a stable and secure environment in which the Canal can operate smoothly to the benefit of all users. Second, Panama's economic development, as well as settlement of the longstanding Canal issue, should markedly improve the investment climate in Panama. We expect foreign and domestic private investment to rise appreciably, leading to increased employment and reduced budgetary pressure on the Government of Panama.

As for the funding for payments of these benefits, it will not be necessary to seek appropriations for any of the economic elements of the cooperation package since all the programs are currently established and on-going.

Funding for Export-Import Bank programs is provided by reflows on outstanding loans, borrowing from the Federal Financing Bank, and various fees charged by the Export-Import Bank for guarantees, loan commitments, and insurance. The proposed financing of COFINA would not require appropriation since OPIC will be extending a guarantee rather than a loan. Such guarantees are backed by an OPIC reserve fund emanating from fees it charges for loans, guarantees, and insurance. Similarly, the AID program would not require appropriation because it is extending a guarantee to private U.S. lenders. The AID housing guarantee program also maintains a reserve fund emanating from the guarantee fees paid by the borrower.

*Question 2.* List the U.S. costs and benefits associated with the treaties, including:

*Question 2A.* Any prospective increase or decrease in Treasury receipts associated with the terms of the Canal treaties:

*Answer 2A.* It cannot be definitively determined whether net Treasury revenues will increase or decrease as a result of the new financial provisions of the treaties. The character of receipts and outlays will change as indicated in the response to item 4, but the key determinant of the net impact of the treaties on the Treasury will be whether revenues cover expenses. All net changes in revenues and outlays of the Panama Canal Commission must, of course, ultimately be reflected in Treasury's bookkeeping.

One change will occur because the Canal Zone Government will no longer exist. The new Commission, a self-sustaining entity, will finance from its revenues those residual government functions which it will continue to have. While accounting techniques will change, however, the net result—that all functions will be financed from Canal revenues—will be no different than it is now. Congress will still continue to maintain its budgetary control over these expenditures, but under the Government Control Act, rather than through the appropriations process.



Another change will be that the Administration will seek implementing legislation such that Treasury will no longer receive interest payments from earnings. However, Treasury may also receive dividends from earnings if earnings and working capital requirements permit, thus possibly offsetting to some extent the decrease associated with the change in interest.

Based on the best information available to us and our negotiators, we expect that revenues will exceed costs over the life of the treaty. Consequently, we anticipate that there will be no net outlay by the Treasury. However, whether Treasury net receipts will increase or decrease depends on the extent to which net earnings allow sufficient dividend payments.

*Question 2B.* Changes in the assets of the U.S. Government;

*Answer 2B.* Please refer to 1B above.

*Question 2C.* Prospective increases or decreases in appropriations required for U.S. activities now in the Canal Zone;

*Answer 2C.* At present appropriations are sought to cover (a) the costs of the Canal Zone Government, (b) annuity payments to Panama under existing treaties; and (c) expenditures in respect of the military in the Canal Zone. Under the new Treaty arrangements, the Canal Zone Government will no longer exist as such, and it will not be necessary or appropriate to continue to seek appropriations. In addition, payments required under the treaty will be from revenues of the Panama Canal Commission, so that it will no longer be appropriate or necessary to seek appropriations in respect of those payments. (Such appropriations in the past were basically offset by Government revenues plus reimbursements from the Company.)

There are three areas not directly related to the operation of the Canal Commission which may require appropriations. First, under the provisions of the treaty, the Department of Defense will assume responsibility for the operation of schools and hospitals in the Canal Zone. Since users of these services will pay for them, it is anticipated that the net increase in expenditures resulting from this transfer of functions will be minimal, mainly to cover administrative and relocation costs. A small appropriation may nevertheless be sought for this purpose.

Second, appropriations may be required to pay for the cost of U.S. Government vessels transitting the Canal. In the past, the cost of such transit was treated as an offsetting item against certain obligations of the Panama Canal Company to the Treasury. Under the new procedures, which are designed to be consistent with sound budgetary principles, U.S. Government vessels will pay tolls directly. If this expense cannot be met from operating budgets, an appropriation for this purpose will be necessary. However, it should be noted that this change merely reflects a change in accounting procedure and will not result in increased net outlays for the Treasury.

Third, an appropriation to the Civil Service Commission arising from the employee provisions of the treaty may also be necessary.

*Question 2D.* Decreases in user's surplus value of Canal to U.S. users if toll increases are effectuated;

*Answer 2D.* To be provided by the Maritime Administration.

*Question 2E.* Monies to carry out obligations in connection with employee provisions of the the treaties;

*Answer 2E.* To be provided by the Department of the Army.

*Question 3.* The note of Secretary Vance to Panamanian Ambassador Lewis unilaterally commits the United States to certain economic and military cooperation with the Republic of Panama. From the viewpoint of the Executive, how is implementation of this commitment related (if at all) to a ratification and implementation of the proposed treaties? How does this commitment to Panama relate to U.S. economic and security interests in the Canal?

*Answer.* The economic cooperation package is designed to help promote stable economic growth in Panama, which we believe is the best way to ensure the security and smooth operation of the Panama Canal. While the desirability of such a program developed out of the Canal negotiations, it is separate from the treaty itself. To avoid any implication of a formal linkage between the cooperative programs and the treaties, it was considered important that the treaties should not mention the economic cooperation arrangements and that the note describing the arrangements should not refer to the treaties.

From a legal perspective, it is important to understand that Secretary Vance's note to Panamanian Ambassador Lewis does not constitute an agreement between the United States Government and the Government of Panama; the note is a

form of a unilateral diplomatic communication from the Secretary of State to the Panamanian Ambassador.

*Question 4.* Possible financial relations between the Department of the Treasury and the Panama Canal Commission. At present, the Department of the Treasury has a number of specific financial relations with the Panama Canal Company. These are set out below. Whether these relations will continue will depend in large part on Congress' decisions when enacting implementing legislation. The Administration's proposals are set out as recommended positions.

A. Company cash assets exceeding current requirements are deposited in Treasury.

*Recommendation.*—It is usual practice for government corporations to maintain cash revolving funds with the Department of Treasury. Accordingly, it is recommended that this practice be continued for the Panama Canal Commission.

B. An annual interest payment on the net direct investment of the U.S. government in the Panama Canal Company is made to the Treasury.

*Recommendation.*—The Administration will recommend repeal of this interest payment requirement.

*Additional Information.*—In the course of Treaty negotiations, and in light of the special circumstances projected in respect of tolls increases, expenses, and payments to Panama, the negotiators determined that foregoing interest payments was necessary and appropriate to obtain the Treaty and to serve the broad economic and foreign policy objectives of the United States.

The USG does not ordinarily seek to recover its cost of capital via interest payments for public investment programs, such as infra-structure projects, when broad national policy objectives dictate that this occur. In fact, from 1903 to 1950, Treasury did not seek to recover its cost of capital from the Canal, which served broad defense as well as foreign policy and economic goals. In 1950, at a time when the Panama Canal Company was established as a self-sustaining entity, Congress put actual Canal operations on business-like basis, and directed that the USG recover its cost of capital.

The assumptions that applied in 1950 no longer hold true. During the course of treaty negotiations, the negotiators sought to balance 3 objectives: (1) to keep the Commission self-sustaining; (2) to help assure Panama's stake in the efficient operation of the Canal while providing Panama with an equitable share of the benefits, and (3) to avoid an uneconomic increase in tolls. To reconcile these goals, they determined that it was necessary for national policy reasons for the U.S. government to forego the receipt of interest.

One principal function of the interest payment requirement will no longer be of major concern under the new Treaty arrangements. The interest payment, which is now reflected in tolls pursuant to statutory directive, assures that Canal users paid all the cost of operating the Canal, including the cost of capital to the U.S. government. Users would be subsidized if tolls did not reflect this cost of capital. In light of the significant tolls increase anticipated under the new arrangements, and the possibility that tolls may approach competitive rates, the Administration need no longer seek to avoid possible subsidies to Canal users by insuring that tolls reflect the cost of capital to the U.S. government.

C. The Panama Canal Company is empowered to borrow from the U.S. Treasury a total not to exceed \$40 million.

*Recommendation.*—That the existing authority for borrowing up to \$40 million be continued.

*Additional Information.*—As a normal provision for prudent management, it would be appropriate for the new Canal Commission to have the authority to borrow to cover temporary deficits, as does its predecessor institution, the Panama Canal Company. The implementing legislation will request Congress to extend the current authority.

We plan to request a continuation of the existing borrowing authority if \$40 million. Based on the best information available to us and the negotiators, we believe this will be sufficient.

The State Department has recently commissioned a new study of projected toll revenues under differing rates of toll increase, and the Department of the Army and the Panama Canal Company are reviewing costs. If it appears that an increase in the borrowing authority is needed, we would, of course, consult with Congress before proposing legislation.

D. Pursuant to an appropriations enactment, financing for various Canal Zone Government expenses is made by the Treasury. Monies for financing various Canal Zone Government activities are repaid to the U.S. Treasury by deposits of



revenues for Canal Zone Government services and by the Panama Canal Company revenues which are paid to the Treasury as reimbursements for the net cost of the Canal Zone Government.

*Recommendation.*—This practice should end because the Canal Zone Government will not exist under the Panama Canal Treaty of 1977. Any residual "governmental" expenses will be borne by the Commission. Any revenues received from residual government services performed by the Commission will be revenues of the Commission. We anticipate that the amounts involved will not be significant.

E. Dividends of the Panama Canal Company in excess of working capital requirements and plant replacement and expansion are paid into the Treasury.

*Recommendation.*—This practice should be continued so that Treasury can benefit from future surpluses derived from the operation of the Canal.

*Additional Information.*—The present Code provision, which will basically be continued, requires the Panama Canal Company's Board of Directors to appraise, at least annually, its necessary working capital requirements, together with reasonable foreseeable requirements for additional plant replacement and expansion, and to pay into the Treasury in excess thereof.

F. Repayment of the Company to the Treasury is made for appropriations to cover losses sustained by the Company.

*Recommendation.*—Although it is not anticipated that the Panama Canal will incur losses, it is prudent management to maintain the existing provisions.

These Code provisions have not been applied for or invoked during the life of the Panama Canal Company. The Administration anticipates that they will not be applied in the future. It envisions that the Panama Canal Commission will be self-sustaining, and will not require appropriations to cover losses. The pertinent Code provisions can be retained for the reasons of prudent management which led to their incorporation into the Code in 1950.

G. The amount of the U.S. net direct investment in the Panama Canal Company is increased for funds advanced to the Company from the Treasury within such appropriations as Congress may make for capital needs, and also for transfers of assets from other government agencies. The amount of U.S. net direct investment is decreased by the amount of accumulated repayments to Treasury or extraordinary expenditures or losses incurred through directives based on national policy and not related to the operations of the Panama Canal Company.

*Recommendation.*—In order that continuity be maintained in bookkeeping operations, the Canal Company has recommended that this provision be continued.

*Additional Information.*—A principal function of the "net direct investment" concept, as it appears in the Code, is to determine the base against which interest due Treasury is calculated. If the interest obligation is repealed, as the Administration recommends, the Code provisions for increasing or decreasing net direct investment, to reflect certain transfers, will no longer be of significance.

H. Tolls computed but not collected on government vessels which transit the Canal are offset against certain Company obligations to Treasury.

*Recommendation.*—The Administration will recommend that implementing legislation delete the Code provision which permits the President to determine that tolls not be collected on certain government vessels transiting the Canal.

*Additional Information.*—Requiring government vessels to pay tolls will end the current practice of Treasury indirectly subsidizing other agencies which do not pay tolls when using the Canal. It will also help assure that the Panama Canal Commission is self-sustaining. Requiring these tolls payments will also be consistent with budgetary principles, as the costs of using Commission services will be borne by those benefiting from the service.

I.\* The Panama Canal Company reimburses Treasury for certain annuity payments made to Panama.

*Recommendation.*—This practice should be discontinued because the Commission will be making Treaty payments to Panama from its revenues.

*Question 5.* Under the proposed Panama Canal Treaty, the Panama Canal Commission will be a U.S. Government Agency, but the Treaty also provides that the Canal will be turned over to Panama by the year 2000 "in operating condition and free of liens and debts". In light of these and other provisions of the proposed treaty package, what should be done with respect to the unrecovered investment of the United States in the Canal and the net direct investment of the U.S. Government in the Panama Canal Company? Should these be written off when the

\* Not directly requested by the Committee.

new Treaty goes into effect, or at the termination of the Treaty, as a cost of foreign policy? Should the amounts be repaid?

Answer. Under the Panama Canal Treaty of 1977, the U.S. will transfer certain properties at specified times to the Government of Panama.

The provisions of the Panama Canal Code, as modified in the implementing legislation, will govern the accounting entries which will reflect these transfers. It will thus be decisions of Congress that determine the accounting methods for recording the transfers.

The Administration intends to propose in the implementing legislation that the net book value of Company assets transferred to Panama will be written off against the U.S. net direct investment in the Panama Canal Company. Congress has authorized the Company to similarly reduce U.S. net direct investment in the past when Company assets have been transferred to Panama. For example, the U.S. transferred approximately \$9.6 million in assets to Panama in 1958 and 1959, pursuant to the 1955 Treaty, and the U.S. net direct investment in the Company was reduced by a similar amount.

These reductions of net direct investment and equity are basically accounting matters without policy significance. In the past a reduction of net direct investment would have decreased the base against which interest due Treasury was computed, but this would cease to be a matter of importance if, as the Administration proposes, the interest payment to Treasury is ended.

The majority of assets will be transferred, without an exchange of any funds, to the Republic of Panama and to other U.S. government agencies. However, removable property and equipment with a net book value of approximately \$2 million may be disposed of with proceeds accumulating to the benefit of the Commission. Materials and supplies on hand no longer required will be handled in a similar manner.

The Canal Zone Code currently permits the Panama Canal Company to reduce the net direct investment of the U.S. in respect of certain property transfers made pursuant to directives of national policy and unrelated to the operations of the Canal. The reasons of national policy associated with the Treaty will justify reductions in the net direct investment of the U.S. in respect of particular property transfers. The transfers in 1958 and 1959 were written off for similar reasons.

*Question 6.* Under the proposed Treaty and accompanying documents, numerous financial transactions between the U.S., the Commission and Panama are mandated, including, for example, provision of certain utility services to Panama by the Commission with reimbursement by Panama at a later time. If the U.S. Treasury is to be the depository of Commission funds, is there any reason why payments to Panama under Articles III and XIII of the Treaty could not be offset by amounts Panama owes to the Commission and the United States? In what time and manner should each of the payments to Panama under Articles III and XIII be made? (For example, should the payment to Panama of \$.30 per Panama Canal net ton be made annually in one lump sum or as Canal traffic accrues?)

Answer. To be provided by the Panama Canal Company.

Mr. METCALFE. Our next witness is Howard F. Casey.

Mr. Howard F. Casey, Deputy Assistant Secretary for Maritime Affairs, is here today to provide the Commerce Department's contribution to our hearings. We heard some very illuminating testimony from Mr. Casey in the vital interest hearings held in July. Today we hope that Mr. Casey will help relate the financial aspects of the proposed treaties to the U.S. merchant marine and to U.S. international trade. Although we will have representatives of canal users to testify tomorrow, Mr. Casey's testimony will reflect how the treaties relate to the actual effective use of the canal, which is my paramount concern.

#### **STATEMENT OF HOWARD F. CASEY, DEPUTY ASSISTANT SECRETARY FOR MARITIME AFFAIRS, MARITIME ADMINISTRATION, DEPARTMENT OF COMMERCE**

Mr. CASEY. Thank you.

Mr. Chairman and members of the subcommittee, I am Howard F. Casey, Deputy Assistant Secretary of Commerce for Maritime Af-



fairs. I appreciate the opportunity to express the views of the Maritime Administration and the Department of Commerce before this subcommittee and to assist you in your deliberations on the economic and financial ramifications of the new Panama Canal Treaties.

These remarks will outline our major views. I have also prepared direct written responses to the questions that were sent to us by the subcommittee. With your permission, Mr. Chairman, I would like to have that material made a part of the record also.

The chief concern of the Maritime Administration with any change in the status of the Panama Canal is that U.S. operators might face increased operating costs, because of toll hikes for example, and that these increased costs might cause an economic hardship to some of them. Should the canal become unavailable, or its usage cease to be economically feasible for any reason, the markets for the services of some of our operators could be drastically curtailed. Other markets could be captured by operators of larger vessels.

A toll increase of the magnitude that the subcommittee suggests, 25 to 46 percent, is likely to have only a small overall effect on U.S. shippers and consumers. The added cost, if completely passed through to the consumer, would be a fraction of a percent of the landed cost of most canal-transported commodities. Within our \$1.7 trillion economy, the net effect would be negligible.

Exhibit I, which is attached to my written statement, shows the added transportation cost for exports of corn, wheat, and soybeans to Japan for a 30-percent hike in canal tolls. The added cost amounts to less than one-half cent a bushel compared with a present total transportation cost of about 66 cents a bushel.

Studies that we have examined indicate that the resulting net drop of commercial volume through the canal might amount to several millions tons during the first year following the toll increase. The same studies indicate that this volume would be regained within a few years with continued growth in world trade, and the effect of inflation and continuing rises in fuel costs on alternative shipping routes. Of the canal volume initially lost, several hundred thousand tons of carriage might be lost to U.S.-flag operators. This is not a great loss, but again, it could mean economic hardship to some U.S. operators who serve small markets in which added transportation costs cannot be passed on to consumers.

We can, fortunately, look forward to some immediate offsets to the new Panama payments which should help to reduce the amount of any new toll increases needed. I refer to the transit of Alaskan oil and the increases in canal revenues that will result. These revenues are estimated to be about \$36.5 million per year or about 20 cents per barrel in the immediate future. This figure is based on current toll and service rates.

The present all-water alternative to use of the canal in most instances is a route around Cape Horn or, in some cases, through the Suez Canal or around the Cape of Good Hope. For operators of ships that normally transit the canal, use of these alternatives would mean large increases in voyage times and costs. In point of fact, in the event of a canal closure, a considerable amount of cargo would probably be diverted to combination systems of land and sea transport.

For example, present waterborne domestic shipments between the east or gulf coasts and the west coast would rely on land transport completely for many commodities and at least partially for bulk commodities with the construction of pipelines or other transshipment facilities in Panama or elsewhere. Again, some shipping companies, unable to make the necessary adjustments in their operations, would undoubtedly face economic hardship or even total business failure.

It is also our opinion that the suggested toll increases would have a negligible effect on most economies of the world. Several South and Central American countries such as Peru, Ecuador, Colombia, Nicaragua, and El Salvador are relatively much more dependent on the canal in their trade than is the United States or, for that matter, any Asian, African, or European country. Yet even these highly dependent countries are not likely to be hurt excessively by the suggested toll increases.

El Salvador, for example, with its more than \$1 billion foreign trade, about 80 percent of which goes through the canal by our estimates, would face additional toll costs totaling about \$500,000 to \$1 million on its combined exports and imports, given the range of toll hikes suggested.

In terms of imports, consumers in El Salvador would face price hikes of only 0.07 to 0.13 percent given a toll hike of 25 to 46 percent. More significant, however, is the fact that these countries represent some of the small, special markets, such as the U.S. east coast market for Ecuadorian bananas and Colombian coffee that might suffer disproportionately from a toll hike, with a corresponding loss of business for U.S.-flag ships.

The prospective toll hikes to cover new payments to Panama, with further adjustments tied to the U.S. Wholesale Price Index for Total Manufactures, as provided under article XIII of the new Panama Canal Treaty, would of course come in addition to the 50-percent effective toll increase that has taken place since July 1974. The latter did not destroy the markets that I have voiced concern about, and to the extent that future toll hikes reflect general inflationary pressures, to which all competing markets are subject, U.S. operators will very likely be able to operate under those too.

Mr. Chairman, the Panama Canal has great economic significance for the United States and the U.S. merchant marine. Indeed, this significance has been increased by the present necessity of shipping Alaskan crude oil through the canal. Moreover, the canal is beneficial to our Latin American neighbors and to many other nations of the world.

The Panama Canal treaties are evidence of this national and international economic significance. One of their principal purposes is to assure for all nations the uninterrupted use of an efficiently operated canal. Explicit in the treaties is an assurance of reasonable and equitable tolls for users with rates continuing to be established and modified by an agency of the United States during the balance of this century. Because such conditions, if achieved, can only enhance the value and significance of the canal for the U.S. merchant marine and all other users, we support these treaties.

Mr. Chairman, this concludes my prepared statement. I will be happy to try to answer any questions that you may have.



[The following was supplied for the record in response to questions of the subcommittee prior to the hearing:]

QUESTIONS AND ANSWER SUPPLEMENT TO THE STATEMENT OF HOWARD F. CASEY,  
DEPUTY ASSISTANT SECRETARY FOR MARITIME AFFAIRS, ON BEHALF OF THE  
MARITIME ADMINISTRATION, DEPARTMENT OF COMMERCE

*Question 1.* It has been estimated that the provisions of the new treaties would require increases in rates of tolls from 25 to 46 percent or possibly more. Assuming increases in rates of tolls of that range upon the entry into force of the Treaty and smaller incremental increases in subsequent years—(a) What would be the effect on U.S.-oriented and U.S. merchant marine traffic through the Panama Canal? (b) What alternatives to the use of the Canal are available for U.S.-oriented trade and the U.S. merchant marine? (c) In your view, do higher tolls at the Panama Canal accrue to the benefit of the Soviets and the trans-Siberian land bridge? (d) How would the projected tolls changes likely affect the commercial relations of the United States and Europe; Central America; South America; Asia; Australia and New Zealand?

*Answer.* (a) Sensitivity analyses that this agency has examined indicate that U.S. shipping would lose several hundred thousand long tons of cargo with toll increases in this range. The loss would be regained within a few years with continuing growth in world trade if no further rate increase took place. In general, commodity sensitivity to toll increases has decreased since 1974 with the increase in fuel costs and continuing inflation.

(b) The present all-water alternative to the Canal in most instances is a route around Cape Horn or, in some cases, a route through the Suez Canal or even around the Cape of Good Hope. High tolls or closure would force more cargo to be diverted to combination land-sea systems (minibridge) or to total land transport. Pressures for the construction of more pipelines and transshipment facilities would also develop. Such developments would force changes in U.S. shipping operations that some of our companies would probably be unable to accommodate.

(c) The existence of the trans-Siberian land bridge has not significantly affected the U.S. oceanborne foreign trades. This land bridge serves the trade between Japan and Western Europe primarily. The latest reports of European observers seem to place its share of that trade at about 10 percent of the total. In 1976, the land bridge moved an estimated 80,000 twenty-foot equivalent containers, with the majority moving from Japan to Western Europe. A Panama Canal toll increase could conceivably cause a further shift of cargo to either the trans-Siberian land bridge or to the Suez Canal.

The development of the trans-Siberian land bridge together with the reopening of the Suez Canal in 1976 were two major events that corresponded with the decrease in volume of cargo moving in the Europe/Far East trade via the Panama Canal. To what extent each of these events was responsible for the decrease is not known, but the volume of cargo moving through the Canal in this trade declined from 10,028,000 long tons in fiscal year 1975 to 5,914,000 long tons in 1976, according to the Annual Report of the Panama Canal Company for fiscal year 1976. Total Canal volume also declined in fiscal year 1976, probably reflecting the continued depressed state of world trade in that period.

The decline in the Europe/Far East trade may be almost entirely a reflection of this general condition.

(d) Very little in all cases. The principal effects would be felt in the small, differentiated markets that we have cited before: The U.S. East Coast markets for Colombian coffee and Ecuadorian bananas, for example. These markets could disappear, but we do not foresee that the net impact on U.S. trade would be great.

*Question 2.* (a) What part does the Panama Canal play in the movement of crude oil and petroleum products, especially petroleum imports into the United States? (b) What are the options available for movement of Alaskan oil to the East Coast of the U.S.? (c) How does use of the Panama Canal for movement of Alaskan oil affect the price of petroleum and petroleum products on the East Coast? (d) What would be the effect of petroleum prices of increases in tolls in the range of 25 to 46 percent?

*Answer.* (a) The total movement of petroleum and petroleum products is a relatively large part of Canal traffic but a relatively small part of total world and U.S. petroleum movements. U.S. crude oil imports through the Canal in 1976 were on the order of 3 million long tons as compared with a total of about 250 million long tons of crude imported into the U.S. in the same year.

(b) At present, the only practical option for the movement of Alaskan oil to the East Coast is to carry the oil from Valdez to the Pacific entrance to the Canal in a large tanker (VLCC), transfer it to another large, anchored storage tanker, then transfer the oil to smaller tankers for transit through the Canal. This will not be the only option within a few years, however. Various pipeline projects from the West Coast to the Southwest and Midwest have been proposed. On November 10, the Federal Energy Regulatory Commission authorized the conversion of a 669-mile natural gas pipeline to permit Sohio to transport Alaskan crude across the Southwestern U.S. This converted line will be one segment of a 1,013-mile line that will run from Long Beach, California, to Midland, Texas. (Source: Energy Users Report, November 17, 1977)

(c) If the Canal were not available, the tankers involved in Alaskan transport would have to steam an additional distance of 18,000 miles, round trip. The added cost of each trip by a VLCC such as the SS New York which now makes the Valdez to Panama run would be about \$2 million or about \$8.33 a long ton or about \$1.20 a barrel. With an Alaskan oil throughput of 500,000 barrels per day to the Gulf and East Coasts, that would amount to about \$600,000 per day in added transportation costs due to the extended voyage, or \$219 million per year. But there would be a saving of \$36.5 million per year in Canal tolls and charges (at present rates) and a further offset due to elimination of the use of 50,000 DWT and smaller tankers in the transport. The latter would amount to perhaps \$82 million per year. The net increase in cost for transporting Alaskan oil would therefore be on the order of \$100 million. This would be the cost to be passed through for price increases on the East Coast. This could increase East Coast prices by several cents a barrel.

(d) The effect of a toll increase in the range of 25 to 46 percent would amount to 4 to 8 cents a barrel for oil moved through the Canal. Averaged over all petroleum movements, the price effect would be negligible.

**Question 3.** If tolls are increased in the amounts projected, what effect would such increases have on the economy of the United States, including the Gross National Product and U.S. competitive superiority in certain commodities?

**Answer.** The effect would be negligible on the \$1.7 trillion U.S. economy. Total U.S. trade through the Canal in 1976, foreign and domestic, was about 78 million long tons. The added transportation cost for this volume of Canal Traffic with a toll increase of 25 to 46 percent would be \$22 million to \$41 million.

In previous studies of Canal tolls impact and the economic value of the Panama Canal, tolls were considered a positive factor in the U.S. balance of payments. Economically, would this continue to be the case under the new treaties?

**Answer.** Yes. The United States would still be "exporting" a service.

Generally, how would the incidence of the cost of toll increases fall as between Canal users, producers and consumers in the United States?

**Answer.** At present levels of trade, U.S. consumers could be expected to absorb increased costs of \$9 million to \$17 million in increased transport costs of imports and domestic trade, and U.S. producers might encounter some loss in export revenue due to higher landed costs for their products. Users (shipping companies) would be generally unaffected except in isolated cases of small markets in which the added costs cannot be passed on. Those users could be forced out of business.

**Question 4.** Given the increases in the Wholesale Price Index for Total Manufactured Goods of the United States in the last five years, what do you project will be the initial adjustment in the annual payment to the Republic of Panama in connection with the amount per Panama Canal net ton? Project subsequent adjustments for the first five biennial periods.

**Answer.** If inflation can be held to the "desirable" 4 percent level, the Panama Canal net ton toll will be raised by 8.16 percent at the first adjustment and by an average of 8.16 percent with each subsequent adjustment. If the treaty were to go into effect at the end of 1978, the payment to Panama per Canal ton would be as follows:

Year:	Tonnage payment (cents)
1978-82	30.0
1983-84	32.4
1985-86	35.1
1987-88	38.1
1989-90	41.1
1991-92	44.4
1993-94	48.0



If the traffic through the Canal were to be constant over this period at 140 million Panama Canal tons a year, payments to Panama under these adjustments would be as follows:

	[In millions]						
	1978-82	1983-84	1985-86	1987-88	1989-90	1991-92	1993-94
Annual payment.....	\$42.0	\$45.4	\$49.1	\$53.3	\$57.5	\$62.2	\$67.2

If inflation were held to the current 6 percent level, tonnage payments to Panama would be raised an average of 12.36 percent with each biennial adjustment. Tonnage payments and annual payments, again assuming 140 million Panama Canal tons per year would be as follows:

	1978-82	1983-84	1985-86	1987-88	1989-90	1991-92	1993-94
Tonnage payment (cents).....	30.0	33.6	37.8	42.6	47.7	53.7	60.4
Annual payment (in millions of dollars)...	42.0	47.0	52.9	59.6	66.8	75.2	84.3

If the WPI/TM follows the 8-year historical average, about 8 percent, tonnage payments and annual payments to Panama, again assuming 140 million Panama Canal tons per year, would be as follows:

	1978-82	1983-84	1985-86	1987-88	1989-90	1991-92	1993-94
Tonnage payment (cents).....	30.0	35.1	40.8	47.7	55.5	64.8	75.8
Annual payment (in millions of dollars)...	42.0	49.1	57.1	66.8	77.7	90.7	106.1

Note: Payments are raised 16.64 percent with each adjustment.

*Question 5.* The Maritime Administration has projected that U.S. trade along the trade routes that traverse the Canal will "rise substantially over the remainder of the century." How would toll increases of the magnitude of 25 to 46 percent and further incremental increases affect this projection?

Answer. As a qualitative statement, this projection is unaffected. A toll increase of 25 to 46 percent can be expected to depress volume through the Canal by perhaps 2 to 5 million long tons the first year with full recovery of this volume in one or two years. Subsequent indexed toll rises would also have some depressing effect, but since they would be tied to inflationary pressures, and since our expectation is for continually rising fuel prices, their effect on Canal traffic would be even less dramatic.

*Question 6.* List the U.S. costs and benefits associated with the treaties, including decrease in users' surplus value of the Canal to U.S. users if tolls increases are effectuated. . . . (Originally Question 2d addressed to the Treasury Department.)

Answer. "Users' surplus" is a concept that has been used in studies commissioned by the Panama Canal Company, notably in the study, "The Economic Value of the Panama Canal," prepared by Drs. Howell and Solomon of Stanford University in conjunction with International Research Associates. The term refers basically to the difference between what would be a fair value to users for the Canal's services in a competitive market and what users actually pay. When operating revenues are set at levels greater than costs, but less than the cost of alternatives, the difference is realized as profits accruing to the Panama Canal Company instead of to the users. When operating revenues are set at levels approximating or less than costs, and less than the cost of alternatives, the difference is essentially a subsidy shared by users. The decrease in users' surplus is measured by increases in vessel operators' costs and the extent to which these costs are passed on to consumers. U.S. flag carriers paid a total of 11.6 million dollars in tolls during fiscal year 1976. A 46 percent toll increase would have resulted in an added 5.3 million dollars in costs, and, had these costs been passed through, a like reduction in the accumulated "surplus" that consumers had built up through use of an undervalued service.

## EXHIBIT I

## TRANSPORTATION COSTS OF CORN, WHEAT, AND SOYA BEANS FROM DES MOINES, IOWA, TO JAPAN

Shipping route	To coast	Coast to Japan	Total	Added cost for a 30-percent Panama Canal toll hike
Des Moines, Iowa, by water to New Orleans to Japan via the Panama Canal.	\$0.36/bushel	\$0.30/bushel including \$1.29 per Panama Canal ton of vessel.	\$0.66/bushel = \$2640/long ton.	19 cents per long ton or less than half cent per bushel.
Des Moines, Iowa, to New Orleans to Japan via Cape Horn.	.....do.....	\$0.45/bushel	\$0.81/bushel = \$32.40/long ton.	
Des Moines, Iowa, by rail to Portland, Oregon to Japan.	\$0.45/bushel	\$0.35/bushel	\$0.80/bushel = \$32.00/long ton.	

Note: Transportation costs developed from a fixture of September 1977 for a vessel of 33,700 dwt and 15,620 Panama Canal tons.

Source: Foreign Agricultural Service, U.S. Department of Agriculture.

Mr. METCALFE. Do I correctly interpret your statement to mean that if canal tolls are raised greatly, some of the trade now carried by U.S.-flag operators through the canal will be diverted to routes where there are a few or no U.S.-flag operators?

If cargo goes by foreign-flag rather than U.S.-flag vessel, then this would be a loss to the U.S. balance-of-payments situation? Is that not true?

Mr. CASEY. Yes, sir, that is true.

For example, there are some cargoes that now move from the west coast of South America to the U.S. east coast, such as copper and ores and concentrates, which are carried by American-flag liner vessels that operate on a regular route on a regular schedule.

If the Panama Canal were closed, or if the canal tolls were increased to such an extent that the commodities I have just mentioned could not be sold in the U.S. east coast markets, either they would stop moving or they would move in bigger ships, probably in bulk-type ships, around Cape Horn and back up to the east coast.

The U.S. merchant fleet participates to the extent of approximately 31 percent in all of our liner cargoes. We participate to a smaller percentage in bulk cargoes, however, because we do not have many dry-bulk ships in our fleet. Consequently, that cargo that I mentioned above would be lost to American operators and diverted to foreign operators under that set of circumstances.

Mr. METCALFE. On page 1 of your statement, the third paragraph, you seem to indicate that from the operator's viewpoint, excessively high tolls would be just as bad as closure of the canal. Is that correct?

Mr. CASEY. It is a matter of degree. Obviously, closing the canal would be very bad. I think it is very difficult to determine what level of increase of tolls could be anywhere near equivalent to closing. It would have to be extremely high.

I strongly feel that the answer to your question is that increases in tolls could never really be as serious as the closure of the canal.

Mr. METCALFE. There are some who feel that if Panama gains control of the canal, Panamanian-flag vessels would somehow be aided, and the results could be that more trade would be carried on foreign-flag rather than U.S.-flag bottoms. Would you care to comment on that apprehension?



Mr. CASEY. I do not share that view, Mr. Metcalfe.

One thing clear about the treaty is that it guarantees nondiscrimination in flags for canal transits, so we are perfectly satisfied that the treaty language would not create any discrimination against American-flag vessels in favor of the Panamanian flag.

Mr. METCALFE. Thank you very much.

Mr. Modglin, do you have any questions?

Mr. MODGLIN. No.

Mr. METCALFE. Mr. Tannenbaum?

Mr. TANNENBAUM. No questions.

Mr. METCALFE. Mr. Nonnenmacher?

Mr. NONNENMACHER. No questions.

Mr. METCALFE. Thank you very much, Mr. Casey. We very much appreciate your testimony.

That concludes our list of witnesses for today.

The Subcommittee on the Panama Canal will now stand in recess until 10 a.m. tomorrow. I thank you all.

Mr. CASEY. Thank you, Mr. Chairman.

[Whereupon, at 4:35 p.m., the hearing was recessed.]

## ECONOMIC AND FINANCIAL RAMIFICATIONS OF THE PROPOSED PANAMA CANAL TREATIES

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THURSDAY, DECEMBER 1, 1977

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON PANAMA CANAL OF THE  
COMMITTEE ON MERCHANT MARINE AND FISHERIES,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10:33 a.m. in room 1334, Longworth House Office Building, Hon. Ralph H. Metcalfe (chairman) presiding.

MR. METCALFE. The Subcommittee on the Panama Canal will come to order. Good morning. In this, the second day of hearings on the Economic and Financial Ramifications of the Proposed Panama Canal Treaties, we will hear first from a distinguished panel of economic and financial experts. We will then hear from a distinguished panel of top international law experts.

This afternoon, we will hear from a panel of canal users; and then, finally, we will be briefed by committee consultants on the constitutional aspects of the appropriation question as it relates to the treaties.

Before I introduce the first panel of witnesses, I want to defer to any member who may wish to make an opening statement. Let me again repeat the statement I made yesterday: that the committee will take the data that we receive in these hearings and analyze it and hopefully prepare a report. If there are any points made today that need clarification from the executive branch, we will address those questions in writing to the executive; or we will ask the negotiators or the Governor and others to return to testify before the subcommittee answers these questions.

Now, I would like to recognize the distinguished chairman of the Committee on Merchant Marine and Fisheries, the gentleman from New York, Congressman Murphy, for any statement.

MR. MURPHY. Thank you, Chairman Metcalfe, and I would like to congratulate you on the hearings of yesterday and, of course, of today, and the oversight that you have so carefully been conducting on an issue so vital to all Americans, and one which is now very vital to the Congress because of the pending treaty.

At hearings held before the Senate Foreign Relations Committee and the House Committee on International Relations, I personally pointed out numerous critical defects in the Panama Canal Treaties, and I am pleased to note that some of these defects have been addressed and clarifications issued by General Torrijos. However, these clarifications are meaningless unless set forth in the body of the treaties.



While I continue to favor the concept of a new treaty with Panama, I cannot see how the Congress can approve such patently flawed documents. The treaty agreements are vague and ambiguous, and will inevitably lead to continuous bickering and harassment.

It is obvious from the testimony of witnesses given before this subcommittee yesterday that some very basic issues relating to the economic aspects of the treaties have as yet not even been addressed.

In short, these treaties will create more problems than they will solve unless they are redrawn so as to spell out clearly, unequivocally, and succinctly the rights and obligations of the parties thereto.

If U.S. warships have priority of passage—let it be clearly stated in the treaties. If the United States has the right to intervene to protect its interest in the canal—let it be clearly stated in the treaties. If payments to Panama are to be generated only from canal operations—let it be clearly stated in the treaties.

If, however, the payments to Panama are to come from other appropriated funds, as has become more and more obvious—namely, from the U.S. taxpayers' pockets—then let it be clearly stated in the treaties.

Let us not interpret these treaties one way in the United States and another in Panama. If we are to have new treaties with Panama, let us be sure that the Congress fully understands the commitments and undertakings imposed upon the United States.

Let us be sure that Congress understands that we are dealing with the disposal of U.S. properties worth billions of dollars and with appropriations of billions more in U.S. taxpayers' funds. By Congress, I of course refer to both the House of Representatives and the Senate.

Administration officials have already made it clear that they intend to convey to Panama property belonging to the United States in the Canal Zone without the requisite congressional approval as mandated by article IV, section 3, clause 2.

Now, it is apparent that there will be an attempt to circumvent the House in the matter of appropriations in total disregard of article I, section 9, clause 7 of the Constitution.

The proposed treaty requires the payment of billions of dollars to Panama without specific approval by the House of Representatives. The provisions of the proposed treaty for payment to Panama out of canal operating revenues are appropriations of public funds that under the Constitution require prior action by the Congress.

The proposed Panama Canal Treaty provides that the United States will operate the canal "By means of a United States Government Agency called 'The Panama Canal Commission' which shall be constituted by and in conformity with the laws of the United States."

The canal operating agency would be subject to the laws of the United States applicable to the disbursement of public funds, and payments of expenses by the new agency, including the payments to Panama, would have to be provided by appropriations.

Provision for such payments out of canal operating revenues without appropriation by the Congress is clearly in contravention of article I, section 9, clause 7 of the Constitution.

Mr. Merrill Whitman, consultant to the Merchant Marine and Fisheries Committee, will be dealing at length with this subject later today.

However important the administration considers the Canal Treaties to be, it does not justify a trampling upon the basic principles established 200 years ago in the U.S. Constitution.

The Members of Congress are trustees for the preservation of the powers of Congress and must continue to exercise diligence to protect and preserve these basic principles which go to the heart of the issue of separation of powers.

And, I might say that the United States will not have the Panama Canal Treaty as the last treaty they will negotiate and I am sure that constitutional rights must be adhered to in this treaty.

Mr. METCALEE. The gentleman from Mississippi, Mr. Bowen. Do you wish to make a statement?

Mr. BOWEN. No comment at this time.

Mr. METCALEE. Thank you very much.

We are very fortunate to have a panel of top economic experts with us this morning. Mr. Leonard J. Kujawa of Arthur Anderson & Co. has delivered superb testimony before this subcommittee on previous occasions. Mr. Kujawa has been studying Panama Canal finances for 15 years and his overall background in the area of finances of Government utilities is unsurpassed.

When it comes to the knowledge of the ins and outs of the principles and details of Panama Canal finances, there is no more knowledgeable an individual than Mr. Philip L. Steers, the second member of our panel. Mr. Steers served as Financial Vice President of the Panama Canal Company for 20 years.

The final member of our panel is Mr. Ely Brandes. He is regarded as the top expert on the relationship of the level of canal tolls and traffic. He has done numerous studies on the subject of toll sensitivity.

Gentlemen, unless there is any objection, we would like to proceed by having each of you read or summarize part of your statement, trying to keep as close as you can to 10 minutes, but making all the points you feel are important.

The subcommittee will then question you as a panel. Mr. Kujawa, would you like to begin.

#### STATEMENT OF LEONARD J. KUJAWA, PARTNER IN ARTHUR ANDERSEN & CO.

Mr. KUJAWA. My name is Leonard J. Kujawa. I am a partner in Arthur Andersen & Co., a certified public accountant, and a member of the American Institute of Certified Public Accountants and other professional societies and organizations. My entire 20 years of professional accounting experience has been concentrated on work for rate-regulated utilities and governmental organizations. Among the private companies for which I have responsibility for my firm's work are United Air Lines, Chicago & North Western Transportation Co., and several other major rate-regulated utilities. Regarding the Panama Canal Company, I have been a consultant on various financial and accounting matters since 1962.

My work for similar organizations has included consulting work for the Suez Canal Authority, for the Atlantic-Pacific Interoceanic Canal Study Commission, which studied the feasibility of a replacement for the existing Panama Canal, and for the St. Lawrence Sea-



way Development Corporation, which is the U.S. entity responsible for operation of the St. Lawrence Seaway.

Arthur Andersen & Co. is an international firm of independent public accountants with 49 offices in the United States and 57 offices in 34 other countries. We serve approximately 50,000 clients and are among the largest public accounting firms in the world. Our relationship with the Panama Canal Company began in 1951 when we assisted in establishing the initial accountability for the property which was to be assumed by the newly formed federally chartered Panama Canal Company. Of more immediate significance is the work we have done through continuous engagements for the Company from 1962 to the present time. Following is a brief description of some of our work:

One. We have consulted with the Company and prepared extensive studies to determine the most appropriate method to assess tolls on individual ships for the use of the Panama Canal.

Two. We assisted in the preparation of the Company's proposals changing the level of tolls to recover increased costs of operation.

Three. We assisted the Company in the computerization of many of its data processing activities.

Four. We assisted in developing its management reporting system for the purpose of controlling and reporting costs at all levels of management.

Five. We have reviewed the Company's accounting policies with respect to cost recognition. Such reviews principally focused upon the adherence of such policies to generally recognizing that the Company is similar to a rate-regulated public utility.

It is a pleasure to return to testify before this subcommittee where, as you know, I have testified on several occasions on financial and accounting matters. Today I would like to evaluate the treaty for you from a financial and accounting standpoint. Based on this evaluation, I will propose certain suggestions for your consideration in the development of implementing legislation.

I fear that the financial aspects of the Panama Canal may be dealt with based on the obvious. Regrettably, what is obvious may not be the fact or the appropriate basis for decisions. In my testimony I hope to sort out for you the obvious from the not-so-obvious as a proper basis for proceeding.

#### THE CONTINUED FINANCIAL VIABILITY OF THE PANAMA CANAL IS VITAL

In testimony before this committee on previous occasions I have chronicled the financial success of the Panama Canal Company. This success is unique in the annals of Government operations. It is the result of several synergistic financial phenomena. First and foremost is the fact that the Panama Canal provides a service of real economic value for which users are willing to pay a price. This price has produced revenues sufficient to maintain the Company's financial viability. Second, there has been traffic growth in terms of both numbers and size of ships, especially in the route between the United States and Japan. Since this growth was utilizing excess capacity, it was the fuel that propelled the financial success machine. Thus it was principally

traffic growth which provided sufficient additional revenues to meet increased expenses and to finance, in part, the replacement, improvement, and expansion of capital facilities. These phenomena, coupled with sound financial policies, have enabled the canal enterprise to maintain its financial strength in spite of significant fluctuations in the world's economic environment.

The recently signed treaty between the United States and the Republic of Panama, however, would provide for the most profound economic changes ever faced by the canal enterprise. These changes impose substantial additional financial burdens on the revenue stream of the canal, including greatly increased payments to the Republic of Panama, divestiture of certain profitable operations, and the imposition of additional operating costs. Will the Panama Canal Commission be financially viable after implementing these changes? Can tolls be increased sufficiently without offsetting traffic losses to produce additional revenues to absorb for the cost increase? There has been much discussion on this matter and before proceeding further I think it is necessary that you understand what constitutes financial viability.

For the Panama Canal Commission to be financially viable, its operating revenues must be sufficient to do two things: to cover all operating costs including those envisioned by the treaty, and to replace plant and equipment when existing plant wears out. It must be capable of achieving this result over the long term. Note that these requirements do not include substantial expansion or enhancement of the canal plant. I'll talk about these betterments later.

A comprehensive study that measures the financial viability of the Panama Canal Commission over a horizon of at least 5 years is urgently needed but not available. As you know, I have been deeply involved in the financial affairs of the Panama Canal Company for many years and this has given me insight into the financial forces that affect the fortunes of the enterprise. In all candor, I am troubled as to whether the Panama Canal Commission can be financially viable based on the treaty for the following reasons:

(1) Impact of inflation: For the past few years the costs of the Panama Canal Company have been escalating at a fast pace due to inflation and now the problem is compounded by the provision for indexing of the substantial payments to the Republic of Panama.

(2) Competition: Although the obvious is that the Panama Canal is a monopoly, the fact is that there are many alternatives available to its use. The alternatives to the Panama Canal are becoming increasingly more attractive, limiting the ability of the Panama Canal to raise tolls so that cost increases can be absorbed.

(3) Diminishing traffic growth: The significant traffic growth rate of the fifties and sixties seems to have disappeared. The only major new source of traffic in recent years is the Alaskan North Slope oil, which is expected to only be a very temporary phenomenon.

(4) Frozen technology: The Panama Canal is a "frozen technology" with costs that are fixed but escalate due to inflation with new alternatives for real cost decreases. This "frozen technology" is less capable of competing with alternatives to the use of the Panama Canal which have available to its new technology.

As my evaluation indicates, there is little basis for optimism regarding the financial viability of the Panama Canal Commission. As you



know, it was only a little more than a year ago that this subcommittee had hearings regarding whether the Panama Canal Company could remain viable. In my judgment, based on data now available, there is as much doubt as there can be assurance that the Panama Canal Commission will be financially viable.

The financial viability of the Panama Canal Commission is vital to the interests of both the United States and the Republic of Panama. Without financial viability there cannot be the proper environment for the harmonious partnership envisioned by the treaty. As I understand it, studies have been started to determine this question.

#### MANAGING THE ROLE OF FINANCIAL GUARANTOR

It would appear that under the treaty the U.S. Government has assumed the role of financial guarantor as manager of the enterprise. There must be a safety valve somewhere because there is no relief provided the Panama Canal Commission in case of financial adversity and it would appear that it is the U.S. Treasury. For this function it is to receive no compensation nor is there any prospect that it will recover its very considerable investment. I have attempted to evaluate the risk assumed by the United States as guarantor as a basis for my testimony. The very essence of an understanding of the financial features of the treaty is the evaluation of the financial risks being assumed. It will be a challenge to the financial management of the Panama Canal Commission to manage its affairs in a manner to minimize these risks. Of special significance is the implementing legislation since it can be a source of financial strength if properly structured.

The features of the treaty contributing most significantly to the financial risks imposed on the Panama Canal Commission include the level of payments to the Republic of Panama, the provision that certain of these payments be escalated based on inflation, and the provision for contingent and cumulative payment to the Republic of Panama.

#### COMPENSATION TO THE REPUBLIC OF PANAMA

The treaty provides for four types of direct payments to the Republic of Panama. Other witnesses have discussed these payments at some length, and I would like to provide you with my insight into these provisions. The payments to the Republic of Panama provide for escalation based on future inflation, except for the contingent \$10 million. This escalation is of considerable financial significance in that it is reasonable to assume that inflation will continue at a rate that will substantially increase the level of these payments. The consequence of this is to impose considerable financial risk on the Panama Canal enterprise due to the magnitude of these payments.

It is by no means clear that future tolls of the Panama Canal can be increased at the same rate as future inflation. As I previously discussed, the Panama Canal is a "frozen technology," whereas the competition to the Panama Canal, in terms of alternatives, can take advantage of the latest technology. Examples of technology improving the competition to the Panama Canal are the ships too large to transit and containerized cargo. Although it may seem obvious that prices can be inflation adjusted, the Panama Canal Company has studied this

issue considerably, and conclusions have been consistently reached that the ability to increase tolls and inflation are not interdependent.

The first type of payment to the Republic of Panama is provided in the treaty under article XIII, paragraph 5, which requires that the Republic of Panama be reimbursed for public services. Since the stated purpose of the payment is the reimbursement for costs incurred, the implementation of this provision should require an accounting of the costs by the Republic of Panama. Cost-of-service type of contracts are common not only between governments and suppliers of services, but also between individual business firms. In such arrangements, it is prudent to provide for the specific types of costs to be reimbursed, for the accounting treatment to be followed, documentary support to be provided, and that the claimed costs will be subject to audit. In consideration of the very considerable sum involved, it would be prudent for the Panama Canal Commission to require similar arrangements in this instance.

The provisions of article XIII(4)c provide for a contingent annual payment to the Republic of Panama of \$10 million which, to the extent if not paid in any year, assumes a cumulative obligation of the Commission. If the treaty were in effect for 20 years, the aggregate obligation to the Republic of Panama under this article would be \$200 million. As an accountant, I have attempted to understand the nature and working of this treaty provision, and I am having considerable difficulty. If read literally, a payment is due when operating revenues exceed expenditures in any one year. This could mean that one would merely add up the cash received, subtract the cash disbursed, and the differences up to \$10 million would be due and payable. If this is the intended meaning of this article, its impact could be so onerous that the financial health of the Commission would be imperiled. Such a simplistic cash accounting method may be appropriate for a small family-owned business, but it is inappropriate and unworkable for a complex financial enterprise such as the Panama Canal Commission.

I am encouraged that the article does use the word "surplus" to determine whether a payment is due the Republic of Panama in any year under article XIII(4)c. This word could lead to the implementation of the article in a manner that would allow such payments to be made only when the Panama Canal Commission has not only earned as income but also retained sufficient working capital to make the payment. This is no different than any corporation paying dividends to its shareholders after an accounting for all costs. To be workable, this article must be implemented in such a way as to require the Panama Canal Commission to account for all costs for the year, including depreciation, and then determine if there was an income (surplus) as a basis to make a payment.

It is imperative that the annual accounting determination of whether a surplus exists under the provisions of article XIII(4)c be consistent with that utilized as a basis for the tolls-setting processes of the Panama Canal Commission. Costs which are stated for purposes of setting tolls should be identical for purposes of determining the article XIII(4)c "surplus." Otherwise, the objectives of the tolls policy in achieving financial viability of the enterprise will be frustrated by the requirement to make a substantial payment unrelated to the availa-



bility of resources to make the payment. Possibly an illustration would be helpful. Let's assume that in years 1 and 2, due to an adverse event, the Panama Canal Commission lost \$20 million. Tolls were then changed to recover these losses, and in year 3 revenues exceeded expenditures by \$20 million. Under one interpretation of this article, the entire \$20 million would be payable to the Republic of Panama, making it impossible for the Panama Canal Commission to regain its financial health.

It would seem that this contingent obligation would not be a cost for purposes of determining the level of tolls. But, if fortuitously, revenues exceeded all costs, then this "surplus" becomes payable. The actual payment should only come after consideration of the working capital and capital improvement requirements of the Commission. It appears to me that considerable effort is necessary to insure that a workable interpretation of this article emerges so that it does not have a crippling economic effect on the Panama Canal Commission.

#### REQUIRED FINANCIAL POLICY DECISIONS

Due to the profound and extensive changes provided for by the treaty, there needs to be an extensive review and reconsideration of all of the financial policies currently followed by the Panama Canal Company. The fact that such policies have operated effectively and efficiently for the Panama Canal Company does not necessarily mean that they would be appropriate for the Panama Canal Commission. The more important financial policy areas requiring attention to successfully implement the treaty would include:

1. Recovery of U.S. investment.
2. Organizational structure.
3. Financing improvements.
4. Financial controls.
5. Setting and assessing tolls.

I will discuss each of these areas and suggest ways of dealing with them in the implementing legislation.

#### POLICY REGARDING U.S. INVESTMENT IN PANAMA CANAL

A comparison of the 1950 legislation establishing the Panama Canal Company and the recently signed treaty reveals a dramatic change in U.S. financial policy. Under the 1950 legislation, which the Company currently follows, there is imposed a responsibility for an accounting of the investment of the U.S. Government in the Panama Canal enterprise. This includes responsibility for both the recovery of U.S. capital and the payment of interest to the U.S. Treasury as compensation for the use of this capital. Except for \$40 million of capital repaid the U.S. Treasury by the Panama Canal Company, as capital was recovered it was reinvested in replacements and improvements to the Panama Canal.

Of all of the financial features of the treaty, the most significant is the ultimate transfer of all present facilities of the canal to the Republic of Panama without direct compensation. This is a phased transfer to be completed in 1999. Of course, the United States will benefit from the continuing existence of the Panama Canal as a prin-

cipal user, but in the aggregate other countries will continue to benefit more than the United States from the operation of the Panama Canal.

As manager of the Panama Canal through the year 1999, the United States, under the treaty, would function in the capacity of "guarantor" and as "trustee" for the assets of the enterprise. It is unlikely that there will be any return of cash to the Treasury for the very considerable U.S. investment in the Panama Canal enterprise. Accordingly, this leads me to the suggestion that the implementing legislation clearly set forth as U.S. policy the fact that the United States will not seek recovery of its remaining investment in the Panama Canal. The establishment of this policy would remove a source of potential conflict with the Republic of Panama regarding U.S. motives in managing the Panama Canal's finances. There will thus be no question that U.S. management was for the benefit of the Republic of Panama and the users of the Panama Canal.

### *Organizational Structure*

As provided for by the 1950 legislation and as managed over its corporate life, the Panama Canal Company has been a substantially autonomous operation. In part, this autonomy was possible because of the physical remoteness of the canal from the United States and in part it was due to its financial success which presented no problems requiring significant intervention. Its financial autonomy served well the interests of the Panama Canal as a public utility serving world commerce. Being insulated from outside forces was also desirable from a purely operating standpoint. To understand the significance of this feature requires an appreciation of the fact that the Panama Canal is a complex business enterprise with an operation it must perform reliably 24 hours a day for 365 days a year. It deserves to be managed as a business and not as a Government institution.

It seems to me that whether the Panama Canal Commission is composed of a combination of U.S. and Panamanian citizens or eventually all Panamanians, it will best serve the interests of the Panama Canal enterprise, and ultimately the Governments of the United States and the Republic of Panama, if the Commission is granted maximum autonomy and flexibility in managing its affairs.

The organizational structure utilized to provide this autonomy is that of a federally chartered corporation. This structure provides the basis for accountability and control. I conclude that from a financial management perspective the continued maintenance of the Federal corporation should be followed for the Panama Canal Commission.

### *Financing Capital Improvements*

Under Article XIII(1) the Panama Canal Commission has an obligation to turn over the Panama Canal in the year 1999 "in operating condition and free of liens and debts, except as the two Parties may otherwise agree." Other articles give the Panama Canal Commission the authority to make improvements including a third set of locks. It thus appears that the treaty imposes an obligation on the part of the Panama Canal Commission to replace facilities to maintain operating condition but there is no obligation, as such, to make improvements or to expand the canal.



From an operating standpoint, the Panama Canal Commission needs the capability to not only finance replacements but also to improve and expand as needed.

The Panama Canal Company has financed its replacements and improvements by two means: (1) Reinvestment of U.S. capital and (2) net earnings. The Panama Canal Company recovers through tolls the U.S. investment in the canal by depreciating all of its assets over their estimated service lives and including this depreciation cost in the tolls formula. By law, the Company is permitted to retain the funds received through this process and, except for the \$40 million returned to the U.S. Treasury, it has done so for purposes of capital replacements and improvements. Thus, the United States' willingness to forego the repayment of its capital has allowed the Panama Canal Company to both replace and expand its facilities. A second source of capital has been net earnings. Even though the tolls formula provides for a tolls level to recover costs, as a practical matter revenues have generally been modestly ahead of costs and therefore net earnings have been generated. These net earnings have generally been plowed back into the canal; that is, they have been used to finance capital improvements for the benefit of the users of the canal.

The basic cash flow from tolls revenue of the Panama Canal Commission must be sufficient to make replacements as needed. The accounting and tolls-setting process to achieve this result will be explored further later in my testimony.

A matter not developed in the treaty is the matter in which capital improvements and expansion are to be financed. As previously discussed, working around the problems created in article XIII(4)c must be developed. One possibility for the financing of capital improvements would be to allow the Panama Canal Commission to impose additional tolls to finance such capital improvements. This would be particularly appropriate for non-revenue-producing improvements such as environmental and safety-related capital additions. The imposition of user charges to finance capital improvements is relatively rare among U.S. public utilities but there is precedent for it. While the Commission would obviously be constrained by such factors as the ability to increase tolls for this purpose, it should be granted the capability to adopt this method of financing should it be deemed appropriate. Obviously, if the Commission chooses this method of financing certain improvements, the resultant receipts should not be considered "surplus" under the provisions of article XIII(4)c or otherwise the intended result is frustrated.

The most typical way to finance improvements is through loans. This source is particularly appropriate if the purpose of the financing is to make improvements for the benefit of future generations of traffic. Under these circumstances, the money to repay the loans is collected from the user who enjoys the benefits of the improvement, thus achieving a matching of the costs and benefits.

Potential sources of loan capital would either be the U.S. Treasury or the private sector. Giving a Government corporation the right to borrow money from private sources has precedent in the Tennessee Valley Authority. The advantage to be achieved by having the Panama Canal Commission seek private sources for its capital needs is to enforce its independence and autonomy. The Commission should be re-

quired to achieve financial independence to facilitate the ultimate objective of Panamanian ownership. If the term of the debt would extend beyond 1999, it would need to be approved by the Republic of Panama in a manner whereby they would assume responsibility for it when U.S. control over the Canal passed to them. Improvements should be in the interest of the Republic of Panama if the result is an improved facility to which they receive title in 1999.

#### FINANCIAL CONTROLS

Although I urge that you allow the Panama Canal Commission maximum flexibility in the management of its affairs, there is a need to achieve a balance through the imposition of controls. It is appropriate that the U.S. Government should institute appropriate controls because of its responsibility as financial trustee and guarantor, as I previously discussed.

Financial controls are imposed through the establishment of the accounting to be followed, budgets, audits and congressional oversight. I will speak in some detail regarding accounting later in my testimony.

If the Panama Canal Commission is financially viable, the submission of budgets would tend to be rather routine events in that no congressional appropriation is to be sought. The main function served by the budget submission process to Congress would be to gain assurance that the financial affairs of the enterprise were being prudently managed. Because long-term financial viability is of importance, the Commission should be required to submit 5-year financial plans.

The congressional oversight function is also served by a requirement for an annual independent audit. The implementing legislation should set forth who is responsible for the audit and the scope of the audit. It should further set forth what should be contained in the audit report to be submitted to the congressional oversight committee.

#### THE LEVEL AND METHOD OF TOLLS ASSESSMENT

The financial viability of the enterprise is dependent on the process of setting the level of tolls and selecting the method of assessment.

As established by law, the present policy regarding tolls level is to set tolls to recover costs. Cost is interpreted to be a comprehensive accounting for all costs, including the recovery of capital through depreciation charges. The alternative to a cost recovery policy would be "what the traffic will bear." In my judgment, the continuance of the policy of assessing tolls to recover properly stated costs based on sound accounting should be continued.

There is in the current law authority for the Company to recoup past losses through a process of deferring payments to the U.S. Treasury. Since it is probable that the Commission will not be obligated to make future payments to the Treasury, this statutory provision may require a change. Since the Commission will have no authority to make a profit, the concept of recoupment of past losses will continue, however, to be needed to maintain the financial health of the operation. Accordingly, this authority should be granted to the Panama Canal Commission.



Since the canal was opened, the method of tolls assessment set forth by law has remained basically unchanged. However, it may be desirable to give the Panama Canal Commission the authority to change the present method of tolls assessment based on the Panama Canal net ton because the financial burdens imposed on the Panama Canal Commission, as previously discussed, may make it appropriate to adjust the burden on individual users. This would be especially important if the level of tolls is increased significantly through frequent toll increases.

Alternative toll systems which consider the type and amount of cargo of the laden ship may be necessary to avoid pricing the Panama Canal out of the market for certain traffic.

Under present law, toll changes require "notice and hearing" as provided by the Administrative Procedures Act. This is of value to the users of the canal in that they are given the opportunity to comment on the proposed tolls and can plan for future costs of using the canal. The requirement for notice and hearing on tariff changes is universally prescribed for by public utilities. Since the user has a very real for changes in either the level or method of assessing tolls should continue.

#### ESTABLISHING ACCOUNTABILITY

The Panama Canal Commission should be required to follow sound accounting in the management and reporting of its financial affairs. Sound accounting is recognized to be a body of knowledge referred to as "generally accepted accounting principles." These principles are the same and practiced in the private sector in both the United States and the Republic of Panama. Accordingly, the implementing legislation should set forth that the Panama Canal Commission will be required to follow generally accepted accounting principles.

The accountant is essentially a scorekeeper whose function is to measure the financial fortunes of an enterprise. To accomplish this objective there must be a proper starting point for the Panama Canal Commission. One possible approach is that the Panama Canal Commission is simply a continuation of the affairs of the Panama Canal Company and, therefore, the stated amounts on the balance sheet of the Panama Canal Company should be carried forward to the newly created Commission. I have given this matter careful consideration and have concluded that this is probably not the proper approach. A new basis of accountability is required.

The present financial affairs of the Panama Canal Company are premised on the 1950 legislation requiring an accounting for the U.S. investment based on amounts stated at original costs dating back to 1904. If the policy is now changed to one wherein the United States does not intend to recover its investment, then a different approach may be appropriate.

I have concluded that the accountability of the Panama Canal Commission should be based on the replacement cost of those facilities which require replacement for the enterprise to remain operable. These replacement cost amounts should be depreciated in a manner that will reflect prevailing price levels over the service lives of the facilities and this resultant amount of depreciation should be includable in deter-

mining the appropriate tolls level. If this is accomplished, canal operating costs will reflect the consumption of canal capital at current dollars and in order to sustain its financial viability it will be necessary for the enterprise to reflect such cost levels in the tolls revenue requirement. The effect of this accounting may significantly change the depreciation cost currently being reported by the Panama Canal Company.

What I am suggesting to you is that the implementing legislation require a clean cutoff between the affairs of the Panama Canal Company and the proposed Panama Canal Commission. There would be, in effect, what is commonly referred to in the financial world as a financial reorganization. Obviously, considerable effort would be required to revalue the facilities in terms of today's price levels but, in my judgment, this effort is fully justified by the results which would be achieved in terms of the future viability of the Panama Canal Commission.

The Panama Canal Commission's financial reporting should have meaning and significance to the Congress, to the users of the Panama Canal, and to the public. These financial statements should indicate whether the enterprise is maintaining its financial viability or whether it is in financial difficulty. The Commission would generate a profit or surplus only if its tolls exceeded all its costs, including the consumption of capital necessary to sustain itself. In my opinion, this is also the proper definition of surplus in determining whether a payment is due the Republic of Panama under the provisions of article XIII(4)c.

#### CONCLUSION

There is much work to be done before the financial impact of the treaties is measured and the implementing legislation developed for their successful implementation. The financial issues are complex because what is being transformed is not the operation of a "Canal Ditch" but virtually an entire economy currently operated by the Panama Canal Company/Canal Zone Government.

The financial impact of the treaty is, in my judgment, sufficiently important to both the interests of the United States and the Republic of Panama to be prudently controlled and managed. First they must be reasonably estimated. This is a big undertaking but must be completed before any other rational planning can take place. Next, the implementing legislation should be developed based on a thorough evaluation of the various alternatives. In my testimony today I have attempted to suggest courses of action that appear appropriate but they require further development. In the implementing legislation the Panama Canal Commission must be given a clear directive of its responsibilities and provided a means for discharge of these responsibilities. While this legislation cannot itself guarantee the continued financial viability of the canal enterprise, if it were not properly constructed it could create a financial cripple leading to financial collapse. I encourage this subcommittee in its insistence that adequate attention be given to the important financial implications of these treaties.



[Questions submitted to Mr. Kujawa and Mr. Steers by subcommittee were answered in prepared text.]

#### QUESTIONS SUBMITTED BY SUBCOMMITTEE

*Question 1.* What aspects of the proposed Panama Canal agreements will have a significant effect on the financing of the Panama Canal operation? How do you believe the structure of the proposed Panama Canal Commission would affect Canal finances?

2. In view of what you believe are the imperatives of financing the Canal enterprise under the proposed treaties, how do you believe that the United States should implement Article III, paragraph 3 of the Panama Canal Treaty, which states that the U.S. shall carry out its responsibilities in reference to operation of the Canal by means of a U.S. government agency "which shall be constituted by and in conformity with the laws of the United States of America"?

3. Article III, paragraph 5 of the proposed Panama Canal Treaty provides for an annual payment of \$10 million to Panama, examined every three years, for the provision of certain specified public services. Article III, paragraph 5 also states that adjustment of the annual payment "should be made because of inflation and other relevant factors affecting the cost of such services (provided)". What, if any, legislative provisions would be useful to promote the equity and efficiency for both countries with respect to this payment? Should this payment be considered a cost of operating the Panama Canal?

4. Based upon your experiences in Canal finances, how should the annual amount of up to \$10 million for payment to Panama under Article XIII(c) of the Treaty be treated—(a) on the books of the agency operating the Canal? (b) in the determination of toll rates?

5. From the viewpoint of Canal accounting, how do you recommend the determination be made of the extent to which revenues of the Canal exceed expenditures for purposes of the \$10 million payment to Panama provided for by Article XIII, paragraph 4(c) of the Treaty?

6. Paragraph 1 of Article XIII of the Panama Canal Treaty provides that the Panama Canal will be turned over upon termination of the Treaty "in operating condition and free of liens and debts." What is the import of other economic/financial aspects of the Treaty and related documents on this provision? What measures should be taken, and what questions resolved, in order to insure the U.S. meets the obligation in a timely and orderly fashion.

7. The Governor of the Canal Zone and various experts in recent years have pointed to the need for a larger capital program for the Canal in the years ahead. With the changes specified in the proposed treaties, will the capital program for the Panama Canal Commission assume any more or any less importance than it had with the Panama Canal Company or Canal Zone Government? What changes and what continuity in the financial structure and requirements of the Panama Canal enterprise would best serve the capital replacement program that is needed?

8. The present Panama Canal enterprise has been described as a highly interdependent organization in which changes in one part of the organization greatly affect other offices, bureaus, etc. The Annex to the Panama Canal Treaty lists 20 types of activities now carried out by the Panama Canal Company and Canal Zone Government which are not to be undertaken under the Panama Canal Treaty. How will the cessation of those activities by the Canal enterprise affect the total financing of the Canal? In your opinion, in what manner and in what amounts will the activities that continue to be carried on by the Commission be affected by the cessation of possibly interdependent activities?

9. It has been estimated that the provisions of the new treaties would require an immediate increase in rates of tolls of from 25% to 46%, or possibly more. If your estimates agree with these figures, assume that increases in rates of tolls of that range will occur: (a) What would be the effect on traffic through the Panama Canal and future toll rates? (b) What will be the effect on the long-run financial viability of the Panama Canal?

10. In addition to meeting its operating expenses, the Panama Canal Company now has a number of statutory financial obligations such as payment on the net direct investment of the United States in the Canal enterprise, repayment of any appropriations made to cover Canal losses, and several other obligations. In view of the obligations to the Republic of Panama incurred under the

proposed treaties, do you think the present financial obligations of the Canal to the U.S. should be reconsidered? Which requirements would be least needed or relevant under the proposed Commission? Which requirements would be most beneficial to U.S. taxpayers and the U.S. Treasury? Which would be most useful for maintenance of moderate rates of tolls?

11. If there is a need to do so, how might the tolls base for the Panama Canal be changed to meet U.S. obligations under the proposed treaties and maintain a "self-sustaining" Canal enterprise?

12. Do you believe that the costs of joint protection and defense of the Panama Canal under the Panama Canal Treaty should be paid for in any different fashion from the manner in which defense costs of the Canal are now treated?

13. What provisions for emergency infusions of resources should be made to keep the Canal operating in event of cessation of operations under the proposed treaties?

14. Commentators and government leaders in Panama have from time to time raised questions about or disputed various accounting practices of the Panama Canal organization. In view of the fact that the proposed Panama Canal Treaty provides for four Panamanian citizens on the Commission's Board of Directors and an equal number of Panamanian and U.S. citizens on the Panama Canal Consultative Committee, what prospects are there that the accounting principles which have heretofore governed the Panama Canal will be radically changed without Congressional intervention? Do accountants in Panama accede to any different accounting principles than does the accounting profession in the United States?

#### STATEMENT OF PHILIP L. STEERS, JR., FORMER FINANCIAL VICE PRESIDENT OF THE PANAMA CANAL CO.

Mr. STEERS: My name is Philip L. Steers, Jr. I am the former Financial Vice President of the Panama Canal (Panama Canal Company and Canal Zone Government). I retired on January 1, 1977, after serving for more than 20 years as Chief Financial Officer.

My responsibilities encompassed the entire spectrum of financial and related activity. I was in large part responsible for developing the financial organization and policies brought about by the Panama Canal Reorganization Act of 1950 and for implementing the financial aspects of the 1955 treaty with the Republic of Panama. It is from this background of experience with the Panama Canal that I appreciate the opportunity to share my views on some of the financial implications of the proposed treaty.

My first observation is that upon reading the treaty as a financial expert, there appears to be little, if any evidence of sound consideration of financial and accounting matters. Nevertheless, I believe that the implementing legislation must provide the basic framework within which the Panama Canal Commission will be able to operate a financially viable canal without imposing any further financial burdens on the U.S. taxpayer. The Commission must be self-sufficient, generating revenues to finance its operating expenses, capital program and the payments to the Republic of Panama.

This very committee, about 30 years ago, was faced with a similar task, to develop legislation that would set the course for the Panama Canal Company to be a self-sufficient operation. The committee succeeded and to this day—the Panama Canal Company is able to state that—it has operated at no cost to the U.S. taxpayer.

I see no reason why we should expect otherwise from future canal operations. However, I am certain that self-sufficiency will be difficult to achieve as the outlook for traffic growth is not encouraging and the



financial and organizational morass created by the proposed treaty could well bring that canal to its financial knees.

Recognizing that self-sufficiency will be difficult to achieve, the development of the implementing legislation becomes critical. There are some actions, subject in part to interpretation of the proposed treaty, that would reduce the financial burden on the canal (toll-payers) without placing added costs on the taxpayers, for example:

(a) The management of the Commission must be given the maximum amount of flexibility possible, though effective operating control must be maintained by the United States during the life of the proposed treaty—this will not be easy within the organizational framework established by the proposed treaty.

(b) The tolls formula could be changed to one that would maximize revenue yet maintain traffic growth. Costs, however should continue to be the reference point for the required level of tolls.

(c) As I understand the treaty, the United States, on ratification gives to the Republic of Panama various installations and areas, including the Panama Canal. Therefore a new basis of accountability is probably necessary. Depreciation on the canal and these installations may no longer be a cost to the Commission or future tolls. The basis for depreciation may require change.

(d) One approach is to provide depreciation on a replacement cost basis for those fixed assets, for example vehicles, launches, et cetera that require replacement.

(e) Improvements to the canal should be financed either by borrowing from the private sector or by surcharge on toll rates, or both.

Frankly, I am very much concerned as to the financial viability of the canal under the proposed treaty. The payments to Panama under article XIII (b) and (c) are especially disturbing for they will confiscate the cash flow of the Commission. The seriousness of this should not be underestimated. The operating efficiency of the canal must be maintained and this will require a heavy investment of funds in canal improvements in future years. I wonder—should not the Republic of Panama consider waiving the above payments as evidence of its real participation in assuring an efficient and reliable operation of the canal? There should be some “give,” not all “take.” The main purpose of the proposed treaty is said to serve the interest of world peace and world commerce. Should not the Republic of Panama be challenged to assume her responsibility toward this goal with the same nobility of purpose as is expected of the United States?

#### ECONOMIC MATURITY

As we examine the many financial problems imposed by the proposed treaty, it is important to keep in mind, that the Panama Canal has reached economic maturity.

During hearing on the Panama Canal held by this committee on July 25, 1977, Mr. Leonard Kujawa, a witness, made the following statement:

Panama Canal traffic levels grew dramatically in the past 25 years leading to the conclusion that it would soon run out of capacity. Present projections indicate a moderate growth for the remainder of this century—the Panama Canal has reached economic maturity. This maturity presents the problem of how to finance cost increases that are likely to occur. \* \* \*

I agree with Mr. Kujawa's views. The Panama Canal may be likened to the U.S. railroads during the early years of this century. The managers then had reason to believe that railroad traffic would continue to grow to the top of the charts. But alternatives came along, such as trucks, airplanes that soon brought the railroad to a lingering financial crisis. The Panama Canal is also faced with competitive alternatives, such as the land bridge, large ships, pipelines among others that are available to the shipper should toll increases cause alternatives to become economically attractive.

The financial outlook is clouded by the fact that there has been no growth in transits over the past 3 years. Oceangoing traffic for 1977 continued its decrease which started in 1975, as shown in the following tabulation:

[Transits commercial oceangoing vessels]

1974 -----	14, 033
1975 -----	13, 609
1976 -----	12, 099
1977 -----	11, 866
1977 (Estimated—proposal to increase tolls) -----	12, 693

Note, also, that the transits for 1977 were less by 827 than that projected in the proposal to increase tolls, dated April 1976.

For the moment traffic growth and solvency appears to be contingent upon the amounts of revenue that may be realized from transits of North Slope oil. The oil traffic, however, at best would be only a temporary solution.

Without real growth in traffic the burden of increased operating and capital costs must fall on a relatively slow growing traffic base. This could mean increasing tolls to the shipper, perhaps to a point where he will search for a more economic alternative. Should the canal be unable to recover its operating costs, does the burden then fall on the American taxpayer?

#### LOSSES

Let us assume for a moment that the Commission is not self-sufficient, that traffic levels do not generate sufficient funds to meet operational expenses, including payments to the Republic of Panama. This puts the United States—who has operational responsibility—in a difficult position. There will be immediate conflict with the Congress, for, I am certain, that is where the Commission will turn for funds.

Recognizing this problem as a possibility, provision should be made in the legislative package to cover such shortfall or loss. However, it should provide for priority of pay back from subsequent earnings, having at a minimum priority over the payment required by article XIII (b) and (c).

#### TOLLS

To meet the financial requirements of the new treaty an increase in tolls will be required. Governor Parfitt in his statement of September 29, 1977 to the Foreign Relations Committee of the Senate stated:

The initial toll increase might range from 25 percent to 40 percent depending on several variables, key among which is the amount of revenue realized from transits of North Slope oil through the canal.



Note the qualification "initial" toll increase.

The need to generate additional revenues becomes critical. I suggest that the time is opportune, particularly as a new legislative program is under development for canal operations, to give serious consideration to changing the formula by which tolls are computed. A new system could generate additional revenues beyond that possible under the present system, may become a necessity. Costs, however, should be the reference point for the level of tolls needed.

An example of a tolls system that could meet this objective would be to assess tolls on the basis of:

(a) A ship charge based on the existing Panama Canal net tonnage (or universal measurement system), plus (b) A surcharge based on the type and quantity (long tons) of laden cargo.

The ship charge would be designed to produce a substantial amount of revenue. All additional revenue would be produced by a surcharge based on cargo carried.

This system would differentiate tolls by commodity based on relative value of service. It would meet the objective of producing substantial additional toll revenue while minimizing the traffic losses that would result from increasing the toll rates. Through the ship charge, the system would retain an important element of the present method of assessing tolls so as to minimize for users the impact that would result from a change in toll systems. This system would tend to stimulate to maximum traffic growth.

I refer the committee to the following reports, copies of which are in the files of this committee: (a) Report on Development of Tolls Analytical Date (May 1969); (b) Report on Impact of Universal Measurement System (March 1970); (c) Report on Development and Evaluation of the Tolls Policies and Alternatives System (November 1970; and (d) Reevaluation of Universal Measurement System (October 1974).

#### OWNERSHIP OF THE PANAMA CANAL

The meaning of paragraphs 1 and 2(a) of article III of the treaty is somewhat uncertain, particularly as I relate it to the question: Who owns the Panama Canal?

Article III tells me:

(a) that the Republic of Panama grants to the U.S. the right to manage, operate and maintain the Panama Canal with its complementary works, installations and equipment,

(b) that the U.S. may use without cost, except as provided in the new treaty, the various installations, including the Panama Canal.

Therefore it appears, that all facilities of the Panama Canal—upon ratification of the proposed Treaty—become the property of the Republic of Panama who concurrently authorizes their use by the United States. If this interpretation is correct, it follows that depreciation on these facilities may not be a cost to the Commission and a new form of accountability becomes necessary.

The question then arises, how will capital improvements and replacements be financed.

#### FUNDING CANAL IMPROVEMENTS

I turn first to the consideration of financing improvements to the canal.

Since 1950 capital improvements have been funded from resource generated by the Company. During this period annual capital expendi-

tures for canal improvements and capital replacement have approximate \$11 million. This amount is about equal to the annual payment to Panama under article XIII (c), which requires that the Commission shall pay up to \$10 million per year out of the canal operating resources to the extent such revenues exceed expenditures and that any unpaid balances shall be paid from operating surplus in future years. This payment in itself would absorb the cash flow that has in the past has been a source of funds to finance capital expenditures.

The wording of article XIII (c) requires some clarification. This section refers to the payment of cash from revenues that exceed expenditures. It could be interpreted that the intention is to make this payment after all expenditures for both operations and capital programs have been made. Thus this payment would be subordinated to capital outlay. Or—it might be interpreted as the excess of revenues over expenditures for operation, including the payments to Panama—likened to a profit or loss.

While this must be clarified, I nevertheless recommend that the draft legislation provide for either or both of the following additional methods of financing canal improvements:

(1) Authorizing the Commission to borrow from the private sector. I encourage this, because it would bring with it financial disciplines imposed by the lender that otherwise would not exist, if, say, funds were borrowed from the U.S. Treasury.

(2) That the tolls formula provide for a surcharge to finance improvements to the canal, funds to be placed in cash reserve for improvement projects.

As an aside, consideration might be given that the responsibility of lending funds for canal improvements—not covered by resource generated from the canal, be the responsibility of the Republic of Panama, the proposed owner of the facility.

#### CAPITAL ASSETS REQUIRING REPLACEMENT DURING THE LIFE OF THE TREATY

It is obvious that many of the capital assets, for example, motor vehicles, machine tools, and so forth used by the Commission will require replacement before the proposed treaty expires. To provide funds necessary for replacement, I propose that depreciation be accrued on this type of assets on a replacement cost basis. The cash flow from this depreciation should be specifically reserved for capital replacements.

This approach will assure funds for a capital replacement program essential to maintain an efficient operation.

#### EXCESS FUNDS OF THE COMMISSION

I suggest that the payment under article XIII (c) be based on an annual appraisal by the Board of Directors of the Commission, of its necessary working capital requirements, together with reasonable, foreseeable requirements for canal improvement and capital replacement, giving consideration to uncommitted balances in any funded reserves established for capital programs.



## ACCOUNTING TREATMENT OF CERTAIN COSTS

I now turn to the accounting treatment of certain costs. The annuity of \$10 million to be paid under article XIII (b), I suggest, be accounted for as an operating expense of the Commission and be recovered through the toll rates.

The annual payment up to \$10 million under article XIII (c) is contingent of revenues exceeding expenditures. I believe this payment, even though any unpaid balance is carried forward as a contingent liability, is "contingent" and therefore not an operating cost, nor a cost to be recovered from tolls. Its payment is based on profitability.

The annual payment under article X-5, initially of \$10 million for certain specified services furnished by the Republic of Panama is an operating cost of the Commission. This cost should be recovered through the tolls to the extent revenues covering these costs are not recovered in other rates. It is possible that some of this payment may represent services received by other U.S. Government agencies.

## REIMBURSEMENT BY THE COMMISSION OF OTHER AGENCIES

The proposed treaty passes responsibility for operation of schools and hospitals to the U.S. military. In the past Government agencies receiving such services from the Canal Zone Government shared the cost of such services. The committee should decide and if necessary provide the legislation for the Commission to reimburse these and other Government agencies for services received and in turn to be reimbursed for any costs it may incur on behalf of other U.S. Government agencies.

## INTEREST ON U.S. GOVERNMENT'S INVESTMENT IN THE CANAL

The treaty is silent on the payment of interest as was required of the Company. I note that Governor Parfitt in his statement on September 29, 1977 before the Foreign Relations Committee of the Senate said, "It is anticipated that the Commission will be relieved of the requirement to pay interest on the net direct investment of the United States in the Canal."

The U.S. Treasury will be deprived of annual revenues now approximating \$18 million. Thus the burden of replacing the \$18 million in Treasury revenue will fall on the U.S. taxpayer. I point this out simply to show that the financial cost of the treaty to the United States is greater than that shown by the text of the treaty. It follows, too, that tolls are relieved of this cost.

## INDEBTEDNESS OF THE REPUBLIC OF PANAMA

Furthermore, the treaty is silent on the long outstanding debt owed to the Panama Canal by the Republic of Panama for services received. As provision is made in the treaty for facilities to be turned over to the Republic be free of indebtedness, steps should be taken by the Congress to press for payment of this debt. Failure to do so increases the benefits to Panama under this treaty by an additional \$7 million.

## EFFECTIVE CONTROL

I believe the operations of the Commission will be hampered by too many bosses. The proposed treaty provides not only for a Commissioner to be the operating head reporting to a Board of Directors—which in itself is sufficient to operate in a business-like manner—but in addition the treaty provides for various types of overseeing Commissions and policymaking committees. Each will be a source of interference with operations—with the result that very little will get done. The treaty is creating a monstrous organization—one cannot expect too much from the Commission under such requirements.

Will the United States be able to maintain effective control of the canal during the life of the treaty? The organizational structure of the Panama Canal Commission, with Americans and Panamanians in high responsible positions—serving as deputies to one another—has within itself the breeding ground of conflict and controversy. Loyalties of employees will be divided, yet operating efficiency is to be the responsibility of the United States. Added to this is the equally serious problem caused by this financial morass as to sustaining effective control of the operation of the canal. Failure to maintain financial viability will bring major conflict between the Republic of Panama and the United States and hostility between the Commission and Congress.

To that end I propose for consideration the following: (a) that the Commission submit—as does the Panama Canal Company today—its budget covering both the operational and capital requirements and their proposed funding for the approval of Congress. Consideration might also be given to require the Commission to secure annual legislative authority in addition to the appropriation process covering its operation and capital program. This latter action would, however, bring more control by the Congress than that which currently is required of the canal operation; (b) that the Commission be subject to the Administrative Procedures Act (5 U.S.C. 553). This is necessary to protect the interest of those who pay tolls and those who as end-users must bear the full burden of all increases in tolls; (c) that annual independent audit be specifically required; and (d) the treaty provides that beginning with 1990 the Chief Officer of the Commission be a Panamanian. This is unique in many ways and its implications should be studied. This change in administrative responsibility might imply that similar change be made throughout the Commission's administration. As the implications of this are reviewed—I suggest, that certain official positions throughout the life of the treaty—within the Commission—be designated as U.S. citizen positions. This should include, among others that may be desired: (1) the Chief Financial Officer; (2) the General Auditor; and (3) the Principal Disbursing Officer.

## ORDERLY MANNER

The proposed treaty provides that the “commercial type of operations are to be turned over to Panama.” However, nothing is said on how to effect the transfer, other than “in an orderly manner.” It is self-evident that we always want things done in an orderly manner. The financial conditions and their impact are so complex that to



achieve the "orderly manner" will require very specific guidance and control.

Let me point out some of the financial problems involved, that need study and policy guidance. The transfer of the commissary is a good example:

(a) What about the stock inventory on the shelves, in the warehouse, in transit or on order, which amounts to about \$4 million. Will payment be made for these, or are they also to be a gift to Panama or to some Panamanian entrepreneur?

(b) What about the accounts receivable (exceeding \$1 million) and outstanding liabilities—are these assumed with the net difference to be settled by payment between the Company and Panama?

(c) There are hundreds of thousands of dollars worth of equipment that are not classified as fixed assets yet have substantial value. Are these items to be passed on free, also?

(d) A physical inventory of the plant and equipment will be required prior to any transfer and its results reconciled to the plant accounting record. Incidentally, a complete physical inventory of all Company and Government plant items will be required. The last complete physical inventory was taken in the early 1950's as required by the 1950 reorganization. This in itself is a major undertaking.

I am really only scratching the surface of a serious financial problem that rears itself for each activity, be it transferred to the Republic of Panama or to the U.S. military.

As some facilities, for example, schools, hospitals will be transferred to the U.S. military, special accounting procedures and policies must be developed. These policies will be different in many ways from those covering transfers to Panama. One should not lose sight of the fact that each transfer, with some exceptions—is a going business.

To add further "fuel to the fire," the present accounting process of the canal is accomplished through an integrated computer system. The transfer of the accounting—for example of the commissary, which is fully computerized—payroll, inventory, cost accounting, purchasing, and so forth, to a third party will be a hair-raising operation. If not properly controlled hundreds of thousands of dollars or material can be lost. This has happened in the business world and could happen to the canal.

A most important step is the immediate development by the Company of statements of policy covering:

(a) The transfer of the assets and liabilities of those operations or parts of operations to the Republic of Panama.

(b) The transfer of the assets and liabilities of those operations to the U.S. military.

(c) The closing out of accounting and financial records of the Company/Government.

(d) The accounting policy and procedures of the proposed Commission.

The Company should also search for steps that could be taken now that would ease the financial transition.

I believe that those principal policy papers should be approved by the Office of Management and Budget and by the Comptroller General.

## TERMINATION OF THE TREATY

Article XIII, paragraph 1, states that upon termination of the treaty the Republic of Panama shall assume total responsibility for the management, operation and maintenance of the canal, which shall be turned over in operating condition and free of liens and debts, except as the two parties may otherwise agree.

This article seems to require that all debts arising from operations must be liquidated by the United States before a facility is transferred to Panama. I believe that the legislative package must provide that the canal be turned over to Panama as a going business—with its assets as well as with its liabilities and related claims.

## CONCLUSION

To unravel all the financial complexities a detailed study and thoughtful foresight is required. To rush in—could result in a financial nightmare, loss of control and chaos to the financial process. Steps must be taken to identify the problems ahead of time, as this committee is doing now, then alternatives considered and policy developed. You are faced with a major financial undertaking, that will dwarf many divestitures experienced in the business world and one—the cost of which could fall heavily on the American taxpayer.

I appreciate this opportunity to highlight some of the major problems as I see them based on my long association with the Panama Canal.

Mr. METCALFE. Thank you very much, Mr. Steers for a very fine statement.

We will next hear from Mr. Brandes.

**STATEMENT OF ELY M. BRANDES, INTERNATIONAL RESEARCH ASSOCIATES, PALO ALTO, CALIF.**

Mr. BRANDES. Thank you, Mr. Chairman.

My name is Ely M. Brandes. I am an economist and I am president of International Research Associates, also of Palo Alto, a small economic research company.

I have been an economist for more than 30 years, having worked for 13 years for the Federal Government, 9 years as a member of a large research organization on the west coast, and since 1968 as an independent consultant and president of my own research company.

Since 1964 I have worked on more than 20 studies for the Panama Canal Company, relating to such subjects as Panama Canal traffic projections, the sensitivity of traffic to toll increases, the economic value of the Panama Canal, the effect of a sudden canal closure, and so forth. It is my understanding that in the last few months, some of these studies have received far more attention than in all the years since their publication.

I recently received an invitation to testify before this committee and, specifically, to address myself to a set of questions on tolls sensitivity. I accepted the invitation and before I give my answers to the



questions posed, I would simply like to say that I regard it an honor and privilege to testify before this committee.

[Below are the questions and my answers thereto.]

#### QUESTIONS SUBMITTED BY SUBCOMMITTEE AND ANSWERS THERETO

*Question 1.* Since it has been estimated that the provisions of the new treaties would require immediate increases in rates of tolls of from 25% to 46%, or possibly more, and assuming increases in rates of tolls of that range:

(a) What effect would such increases have on traffic through the Panama Canal, especially for U.S. shippers and on U.S. consumers?

(b) What alternatives to the use of the Canal would be available to present U.S. users?

(c) How do such alternatives compare to the cost of use of the Canal at present rates and at rates reflecting increases of 25% to 46%?

(d) What would be the comparative effect of tolls increases in the first year of the increase in succeeding years?

(e) How would changes in the magnitude indicated affect the economies of the U.S., Europe, Central America, South America, Japan, Asia, Australia and New Zealand?

(f) What is the ceiling on increases in rates of tolls?

Answer. Before answering this question specifically, I would like to inform the Committee that I am currently engaged in a study, sponsored jointly by the Panama Canal Company and the State Department whose objectives are (a) a set of new traffic projections for the Panama Canal up to the year 2000; (b) new estimates of the sensitivity of Panama Canal traffic to toll increases; and (c) a new estimate of maximum attainable revenue. This report will be completed around the first of February 1978, and it is my understanding that copies of this report will be released immediately to all interested parties, including members of this Committee.

It is apparent that the most up-to-date answers to the above questions must await the completion of this study. However, I believe I can give some approximate answers which are based on earlier studies, completed in 1974 and 1975, and which I feel are still to some extent valid. I will indicate which of my answers will be subject to change based upon the expected results of the new study.

With respect to question 1.a., it is my belief that a toll increase in the range from 25% to 46% would reduce Panama Canal traffic by percentages ranging from about 3% to something more than 20%. Smaller reductions in traffic would occur in response to smaller increases; also, a given increase in tolls is likely to cause a larger decline in traffic five years after it was put into effect than in the very first year of the toll increase. Once the current study is completed, these estimates can be made definite.

These reductions in Panama Canal traffic represent lost business to the Canal. The mere fact that very small cost increases and for most commodities shipped through the Canal, a toll increase of 25-46% would involve a delivered cost increase of less than 1%—cause a rerouting of the cargo is a clear indication that the buyers and sellers have alternatives available which are very close in cost to using the Panama Canal.

The second effect of a toll increase would be that the users of the Canal would, collectively, pay from \$40 to \$75 million a year more in tolls. In a study concerning the economic value of the Canal, in which I participated in 1974, it was determined that U.S. business and consumers are the ultimate payers of about one-third of all tolls paid at the Canal.

We also determine that in most instances it is the buyer or the consumer who is the ultimate payer of the Canal tolls and not the seller or the shipper. Most of the U.S. share in higher tolls, which would amount to about \$13 to \$25 million a year, would be paid by consumers of imported goods such as automobiles, television sets, iron and steel products, etc.

In fact, we have found only one instance where American exporters might have to pay for part or all of the toll increase. This involved the case of California oranges which are shipped to Europe. Because the price of fresh oranges in Europe is set by the much larger shipments from the Mediterranean area, outside oranges sold there must meet the going price and cost increases experienced by American exporters cannot be passed on.

With respect to coal, wheat, corn, soybeans, phosphate rock which are all major American export commodities, the importing countries are the ultimate payers of any increased tolls.

In answer to 1.b., the alternatives available to Canal users depend upon the routes and the commodity involved. For instance, for manufactured goods imported from Japan, the simplest alternatives are ocean transport to a west coast port and rail shipment from there. (This is a very cost effective alternative particularly in cases where the ultimate destination of the cargo is at an interior point and not on the coast.)

In the case of coal exports to Japan, the alternative is to charter a larger ship and go around the Cape of Good Hope. In the case of lumber imports from Canada, the alternative would be shipments by rail from Canada. In the case of iron ore imports from Peru, it might be buying iron ore from somewhere else like Brazil or perhaps even the United States.

In answer to 1.c., the cost of an alternative to the Panama Canal, if it is selected by the parties involved, is by definition less than the amount of the toll increase. Should the alternative cost more, the shipment would continue via the Panama Canal. The fact that a relatively small toll increase can cause a relatively large reduction in traffic means, in effect, that many users have alternatives available to them which are not much more expensive than using the Panama Canal.

In answer to question 1.d., it has been established that the traffic reducing effect of toll increases tends to be greater five or ten years after the toll increase went into effect than in the year immediately following the increase.

One reason for this delayed effect is that the world of foreign trade is largely controlled by contracts and in the short run the only choice is often to pay the added tolls. In the longer run, after current contracts have expired, buyers and sellers are freer to choose alternative arrangements.

It has also been found that an alternative arrangement will often start on a small scale; but after it has proven itself, it may attract more followers and the volume of the diversion from the Canal increases. For instance, some Japanese coal buyers began in the early Seventies to charter an occasional 100,000 to 120,000 ton vessel to carry coal from Norfolk via the Cape of Good Hope at a cost that was comparable to the cost of shipping the coal through the Canal in smaller ships. The first few shipments of this size undoubtedly caused some problems. But these problems apparently have been solved and now 25% of all coal exports to Japan go in these larger ships via the Cape.

With respect to question 1.e, I believe that a toll increase in the range from 25% to 46% would have negligible impact on the economies of the United States and that of other developed countries such as Japan and European countries. With respect to some Latin American countries, a toll increase of such a magnitude would be more noticeable. I believe that one industry in Latin America which would be affected is the banana industry. Bananas are unique in the sense that Panama Canal tolls account for a larger portion of the total cost of bananas than of any other commodity. It is estimated that Canal tolls account for about 5 percent of the landed wholesale price of bananas and an even higher portion of the cost in the producing country, before it is shipped.

Since bananas are produced on the Caribbean side of Central America as well as on the Pacific side, the producers on the west coasts of Central and South America have a cost disadvantage vis-a-vis their competitors and this disadvantage would get worse with a toll increase.

With respect to question 1.f., one task of the study now under way is to determine the maximum toll revenue attainable. Our previous study on this subject indicated that the maximum toll increase attainable was in the range of 75 to 100 percent. Increases larger than that would result in traffic losses great enough to offset the increase in revenue. But this earlier maximum revenue calculation was made before the two recent toll increases and the change in measurement rules were put into effect and the result can no longer be regarded as valid.

*Question 2.* Non-toll charges to Canal users presently make up a large percentage of Canal revenues. What significance do you place on the level of non-tolls charges in relationship to the decision of whether to use the Canal or an alternative route? If non-toll user charges were to increase appreciably, along with tolls, what effect would this have on Canal traffic?

*Answer.* I have never studied the subject of non-toll charges at the Canal; I, therefore, cannot testify about this with any degree of knowledge, except to say that if such charges were to become a significant portion of a ship's total cost of transiting the Canal, any increase in such charges would have the same effect as an equivalent increase in toll charges.

*Question 3.* What particular regions, ports, industries, and commodities in the United States would particularly feel the effect of various levels of toll increases?



Would the impact of increases in the rates of tolls (in the area of 25% to 46%) seriously affect the U.S. economy or any aspects thereof?

Answer. I believe I have answered part of this question under 1.c. It is my conclusion, based on the several studies which I have conducted, that a toll increase in the range from 25% to 46% will not have a noticeable effect on any region or industry or ports within the United States nor will it have a measurable negative effect on the economy of the country as a whole.

*Question 4.* Did the toll increases in 1974 and 1976 and the measurement rules change in 1976 have any effect on Canal traffic? Is it possible yet to determine whether the projections as to the effects or lack of effect of these increases may have proven to be correct?

Answer. Based on preliminary findings from our present study, I would say that the two toll increases and the changes in measurement rules did cause some losses in traffic. We have not yet quantified these losses, but we have identified two definite instances where such losses have occurred. The first concerns the rerouting of Europe-Far East traffic from the Panama Canal to the Suez Canal. Part of this occurred early in 1976; but the largest number of ships on this route left the Panama Canal after the 1976 toll increase went into effect. The ships involved were primarily container ships.

The second instance involves coal shipments to Japan. It is our conclusion that the rate of diversion of shipments via the Cape of Good Hope has increased during the last two years and that part of this is attributable to the rate increases.

Our 1975 sensitivity study had projected that following a 50 percent toll increase there would be a traffic loss of 2 million tons after one year, of 9 million tons after 5 years, and of 11 million tons after 10 years. Actual traffic data show that Panama Canal traffic declined from 148 million tons in 1974 to 122 million tons in 1977, or a decline of 26 million tons. Most of this loss in traffic was caused by the world-wide recession of 1975-1976 but some of it was undoubtedly due to the toll increase.

Finally, I would like to say that while our studies had projected this loss in traffic, other investigators, both here and abroad, had consistently maintained that the cost advantages of the Panama Canal were so great that it would take toll increases of several hundred percent before users would turn to alternatives.

*Question 5.* Absent major increases in tolls, what are the prospects for increases in Canal traffic between the present and the year 2000—(a) by commodity? (b) by type of ship? (c) by flag of user? (d) by trade route?

If there are toll increases of the magnitude of 25% to 46% immediately, and further increases to meet obligations to Panama, what will be the effect on Canal traffic—(a) by commodity? (b) by type of vessel? (c) by flag of user? (d) by trade route?

Answer. The above question covers two of the major objectives of our current study which are (1) to make traffic forecasts to the year 2000 and (2) to conduct a sensitivity analysis which would show the effect of various toll increases on these projections. Since we had never before even made a traffic forecast to the year 2000, I cannot base an answer on a previous study. As I said before, this study will be completed by early February 1978, and I am sure copies of the report can be furnished to this Committee as soon as it is completed.

There is only one element of the above question which our study will not answer, and that concerns projecting traffic by flag of user. We have never been able to make a meaningful correlation between commodities, trade routes and flags of users; and for that reason, we have not considered including any breakdown by flag of users in our projections.

*Question 6.* Much has been written about the type of tolls structure which has been in force at the Panama Canal. In view of the increased obligations to Panama that the Panama Canal Commission incurs under the proposed Treaty, should an alternative type of tolls structure (for example, one based on commodities or alternative routing) be considered?

Answer. Some years ago I participated with Arthur Anderson & Co. in a study of alternative toll schemes for the Panama Canal and based on that experience, my recommendation would be that an alternate toll system should not be considered. As far as I can see, the only significant advantage of an alternate toll system—one involving perhaps a ship charge and a commodity surcharge—would be that its maximum revenue potential might be 10% or so greater than under the present system. (But this advantage would only be of value if it were necessary to obtain maximum revenues from the Canal users.)

Against this one possible advantage there would be two great disadvantages. First there would be the administrative problem of introducing a new and more complex toll system. The second, and even greater disadvantage, concerns the matter of equity. Since the present toll system has been in effect since the opening of the Canal, the users have developed an equity stake in the system which is reflected in the charges actually paid by the various types and sizes of ships. A new toll system would by definition alter these equity stakes and require that some pay more and some pay less than they had before. I believe that the Canal Company had a small foretaste of the reaction which a change in the toll system could produce when it introduced the recent changes in measurement rules. As I understand it, the major objection to these changes was not that they raised toll revenues but that they imposed differential increases on various ship types.

*Question 7.* If a definite schedule of Canal toll increases is to be promulgated, would this have a more or less deleterious effect on Canal traffic than present toll increase procedures?

Answer. I believe that the present procedure of initiating toll increases when, and if, they are needed is superior to one in which toll increases are set in advance. In fact, I believe that under a procedure whereby toll increases are announced far in advance of their occurrence, Canal users would be choosing alternatives not on the basis of the tolls which they are actually paying but on the basis of increases which are scheduled to go into effect two or three years hence.

*Question 8.* In your view, do higher tolls at the Panama Canal accrue to the benefit of the Soviets and the trans-Siberian land bridge?

Answer. No. It is my understanding that the Soviet Union is encouraging shippers of container cargo between Europe and the Far East to use the Trans-Siberian Railroad. Since there is very little Europe-Far East container cargo shipped through the Panama Canal anymore, there could be no losses of such cargo to the Soviet Union.

*Question 9(a).* What part does the Panama Canal play in the movement of crude oil and petroleum products?

Answer. The Panama Canal is not a petroleum canal to the same extent that the Suez Canal was prior to 1967. Still, during 1977, more than 22 million tons of crude oil and petroleum products were shipped through the Canal, amounting to about 19% of all shipments. And at the present time some Alaska oil is being shipped through the Canal.

*Question 9(b).* What are the options available for movement of Alaskan oil to the east coast of the U.S.?

Answer. For at least the next two years or so, the only available options are shipment via the Panama Canal or shipment around the Horn. It is my understanding that the oil companies would have liked to arrange for a crude oil exchange with Japan, with Japan taking Alaska oil in exchange for oil which the Japanese had purchased in the Middle East; but this was vetoed by the Federal Government.

By 1980 or so, there is a good chance that a pipeline from Long Beach, California, to Midland, Texas, will start moving some Alaska oil to the east. This project has received almost all of the necessary approvals, and there is hope that it will receive the final word early in 1978.

There are other pipeline schemes in the talking stage but all of them must still be listed as only possible at this time.

*Question 9(c).* How does use of the Panama Canal for movement of Alaska oil affect the price of petroleum and petroleum products on the east coast?

Answer. This is a difficult question to answer because under present policy, Alaska oil must be consumed in the United States. The fact that some 150,000 barrels per day of Alaska crude oil are currently moving through the Canal is prima facie evidence that for the company involved—the Standard Oil Company of Ohio—shipping the oil through the Canal is the cheapest way right now of accomplishing this objective. In this sense, then the consumers in the East are not paying anything extra because the oil moves through the Canal. It would cost more if it were shipped any other way. How much more it would cost to ship any other way I do not know because I have no knowledge of what size American built tankers might be available for a movement around the Horn. And, as you know, it is the size of tanker which principally determines the shipping cost per barrel of oil.

*Question 9(d).* What would be the effect on petroleum prices of increases in tolls in the range of 25% to 46%?



Answer. At the present time, Panama Canal tolls amount to about 15 cents per barrel of oil, or about one-third of a cent a gallon. A toll increase of 25 to 46 per cent would increase the price of Alaska oil shipped through the Canal by 0.1 cent to 0.2 cent per gallon.

*Question 10.* In previous studies of Canal tolls impact and the economic value of the Panama Canal, tolls were considered a positive factor in the U.S. balance of payments. Economically, would this continue to be the case under the new treaties?

Answer. I believe that under the new treaties, Canal tolls would still constitute a positive element in our balance of payments scheme even though a larger share of such revenues must be paid as royalty to Panama. But these larger royalty payments are a consequence of the treaty and obtaining larger toll revenues will simply improve our ability to make the royalty payments.

*Question 11.* Assuming an immediate toll increase under the proposed treaties of various levels, ranging from 25% to 40%, and assuming annual or nearly annual incremental increases of about 5%, how do you project such toll increases would affect the economic value of the Panama Canal to the United States?

Answer. A simple, yet accurate way of measuring the net economic value of the Panama Canal is to say that it represents—in the aggregate—the difference in cost between going through the Canal and doing the next best thing.

According to the question, it is assumed that the cost of going through the Canal may go up both as a result of a one-time toll increase and then as a result of further but smaller yearly increases.

On the face of this, one might conclude that the difference between going through the Canal and doing the next best thing would shrink, and so would the net value of the Canal. But this is not necessarily true, because we do not know yet what will happen to the cost of doing the next best thing. If it goes up in cost to the same extent as Canal tolls increase, then the net economic value is preserved. But if the cost of doing the next best thing does not increase to the same extent, the economic value will shrink.

I wish that there were a way of making certain forecasts on this matter, but unfortunately there is none. I can only urge that the present and future managers of the Canal maintain a high degree of vigilance concerning this matter, and that they seek to preserve an adequate margin of net value for Canal users. Should they fail to do so and should they increase tolls, without regard to this margin of net value, simply because their costs have risen, we may find one day that we are presiding over a Canal facility that is getting emptier by the year. To me, this would be the ultimate tragedy for the Panama Canal.

This concludes my written statement.

Mr. METCALFE. Thank you very much, Mr. Brandes, and now I recognize the chairman of the Merchant Marine and Fisheries, Mr. Murphy.

Mr. MURPHY. Thank you, Mr. Metcalfe.

Mr. Kujawa and Mr. Steers and Mr. Brandes, it is certainly a pleasure to have such expert witnesses come and bring not only to this committee, but to the entire Congress and American people, some of the very hard facts and cold facts which we are dealing with.

Mr. Brandes, I only make one correction in your statement, when you say we would be presiding over a treaty—we might say that they would be presiding over a canal rather than that was not a viable economic entity that had closed itself by its misoperation to world consumers.

I pointed out to the Senate on two occasions, and to the House International Relations Committee on one occasion, the sentiments that you have stated here today. I did not have the specific arguments that you have so very carefully laid forth, and the answers, and the clarity that that treaty must generate, and I think that there can be no misunderstanding on the part of the United States or on the part of Panama as to exactly what is stipulated in the treaty.

Now, Mr. Steers very clearly points out the structure that is brought into this treaty. There may be a Commission of five Americans and

four Panamanians, but there are two boards composed of four Panamanians and four Americans each.

One—and it is an advisory board—and that is for the operation and control of the canal, and that other board is a board on the defense of the canal, and it is not clearly spelled out what effect the recommendations of that board will have, and I think that the stipulation that through the year 2000, certain officers of the Commission should be Americans is most wise, particularly with the problems that we see adherent, finally, in this enterprise.

We have studied on this committee over the years the changes in the increase and sometimes decreases and sometimes plateauing of canal traffic. We saw that the Korean war caused a sharp increase in canal traffic.

The analyses of canal traffic cannot be done properly without understanding certain historic events and, of course, we cannot predict future historic events that may effect either a decline as we had in the thirties in canal transit, or sharp increases because of the two wars that I have just mentioned.

So that changing pattern alone in transits is something that must be taken into consideration. I think one thing we don't want to see is a Canal Commission in itself trying to meet certain financial responsibilities that are contained in a vague treaty, such as the one we are considering today, dealing away assets that are nonrevenue producing, but are vital assets to the proper operation of the canal. I am talking about schools. I am talking about the entities that make the community of the Panama Canal Company livable for the technical people that operate this canal, and who will not stay under those circumstances because their families would not be afforded certain amenities of life that Americans and technical people—whether they be Americans or not—certainly desire.

So, we could see a situation where that canal just depletes certain of its assets. The main point of paying a certain amount of money to the Republic of Panama—and we know it would only be over a limited period of time before we came to the point that the canal would stop functioning because of the practices that you three gentlemen have so carefully pointed out—to be looked at and that has to be spelled out carefully in the canal treaties—I think we must insist on those practices being laid out in the joint resolution that both the House and Senate would necessarily have to agree to in the implementation of any treaties.

I want to thank you for letting the Congress fully understand just what the financial implications are in these incomplete documents—as I consider them to be—and also think that there is one other instance that we have discussed the financial impact, which is contained in the Panama Canal Treaty.

That point is that the United States can negotiate with no other country for any other interocean or lock type canal. We know a sea-level canal is a far more economic and viable canal to operate and to run. We do know that the tolls at that type of canal would certainly be much lower than the costly lock operation that we are undergoing today, and you pointed out clearly that there are limitations in this canal.



I am going to conclude at this point. Counsel will be asking specific questions that are a preliminary study of your statements and counsel has indicated that we should have clarification for the record.

But, once again, I want to thank the three of you for coming and making your presentations.

Mr. METCALFE. Thank you very much, Chairman Murphy. We are very happy and honored to have you present during these hearings.

Mr. KUJAWA, both you and Mr. Steers suggested that there be a user surcharge to finance capital improvements to the canal.

What is the basic rationale behind this; is it to make sure the money is there to get done what is necessary, or are there other reasons?

Mr. KUJAWA. The rationale is that the users have an interest in an efficient canal, and as indicated in my testimony, it would be particularly appropriate if the type of improvement being made was not in itself revenue producing.

For example, you are trying to achieve a safety related or an environmental improvement. Under those circumstances, I think you can conclude that would be in the interests of the user and certainly, from the financial viability of the canal, necessary to finance the capital improvement from tolls.

Mr. METCALFE. Thank you.

Mr. Steers joined with you in your suggestion that the Panama Canal Commission be able to borrow from private sources. If such a loan were made and terms went beyond 1999, what would be the security for the loan?

Mr. STEERS. I would imagine in that situation the loan agreement itself would have to have the approval of the Republic of Panama, along with the United States, to guarantee it beyond the year 2000.

Mr. METCALFE. What would be the security?

Mr. STEERS. I would say the canal itself might be the security. I would imagine the guarantee of the countries behind it is the basic security.

Mr. METCALFE. Mr. Kujawa, what is your initial reaction to Mr. Steer's suggestion for a new type of toll system; if the system is changed, would that require negotiation with Panama to adjust the 30 cent per cargo ton?

Mr. KUJAWA. It should have no effect on the amount payable to Panama. The only effect would be on the revenue stream of the Panama Canal Commission.

Mr. Chairman, I think that the matter of a different toll system should be left open and not foreclosed to the Panama Canal Commission. It may be necessary, particularly as circumstances change in the future, and tolls are increased, to change the toll system and it would be particularly important if additional revenue was necessary to keep the Panama Canal Commission viable.

Mr. METCALFE. Further, Mr. Kujawa, when you suggest on page 25 that there should be a clear cutoff between the affairs of the Panama Canal Company and the Panama Canal Commission, well, does that mean that the liability of the present Canal Company should not be carried over?

Mr. KUJAWA. Assuming you mean the liability to the U.S. Government, I think that yes, consideration should be given to changing that. I say this because I suspect that the Panama Canal Company's forth-

coming study will demonstrate that the Panama Canal Commission will not be able to repay the investment of the United States in the enterprise. If this is in fact the case, to carry forward the liability then would be interesting bookkeeping, but would have no real substance.

Mr. METCALFE. After reading the article XIII(4)c, which requires an annual amount of up to 10 million United States dollars per year to be paid out of canal operating revenues, do you think that the obligation to the Republic of Panama is cumulative, and further, may I raise this question:

What in your opinion would be the responsibility of the United States to the Republic of Panama in the year 2000, if the United States were unable to make any payments under this section?

Mr. KUJAWA. Well, based on my reading of the treaty document, speaking about XIII(4)c, I assume that such payment is truly contingent and that if the financial affairs of the Panama Canal Commission don't allow for its payment, the debt of the Commission would be increased only until 1999 when the Commission ceased to exist. At that time, there would be no obligation on the part of the U.S. Government to assume the obligation.

Mr. STEERS. May I elaborate just a little further on that?

Mr. METCALFE. Yes.

Mr. STEERS. Minority counsel, I believe yesterday, raised a question in connection with that, and I believe he does have a point.

I would expect the Republic to be pressing for payment of any amounts unpaid after a period of years, and perhaps seeking the payment from the United States.

I'm not sure the Republic accepts this payment as a contingent item. I think that is one item that should be clarified immediately in writing between the two countries.

Mr. METCALFE. I want to continue questioning you, Mr. Steers. The Governor suggested yesterday, on page 13 of his statement, putting capital requirements in excess of depreciation in the tolls base.

How would that relate to the suggestion on pages 2 and 8 of your statement, to provide depreciation on a replacement cost basis?

Mr. STEERS. On the depreciation and replacement cost basis, I was referring to replacement of assets that will wear out during the life of the treaty.

For example, automobiles, launches, or machines, tools. I believe the time has come to provide the funds for that to depreciate those assets in a manner very similar, which Mr. Kujawa mentioned in his statement, on a replacement cost basis so that the funds would be available to the Commission when replacement is necessary.

Now, on major improvements to the canal, I propose consideration of a surcharge on tolls, which would be in the place of depreciation on those assets, or probably more preferably by borrowing from a third party.

Mr. METCALFE. Mr. Steers, you point out the annual number of vessels going through the canal has decreased, but should it not also be pointed out that the size of the average vessel transiting the canal has increased?

Mr. STEERS. Yes, that is correct; the size of the vessels have gone up and added revenue is provided through this growth.



However, I am concerned about the number of units going through the canal, and this decrease is quite important. Tolls for 1977 were the highest ever, but the reason for that was not principally because of the size of the vessel increases, but because there was a significant toll increase for 1977.

Mr. METCALFE. You suggest that the Canal Commission may want to borrow from the private sector. Wouldn't this mean high interest rates would have to be paid—higher rates would have to be paid?

Mr. STEERS. Possibly, but I do know this: The lender would require financial disciplines from the Commission and that would be extremely desirable in the circumstance.

Mr. METCALFE. On the bottom of page 11 of your statement, are you suggesting that this committee authorize annual appropriations for the Canal Commission?

Mr. STEERS. No, I am not. I am recommending that the Canal Commission budget be approved by the Congress, similar to the way they approve the Panama Canal Company budget today.

Mr. METCALFE. Thank you very much, Mr. Steers. Now I would like to ask Mr. Brandes:

The Maritime Administration stated yesterday that a 25 to 46 percent total toll increase would have little effect on the U.S. economy, but a greater impact on the individual ship operators.

Is it correct that you agree with this assertion, but you also point out that such an increase would greatly impact on the canal itself?

Mr. BRANDES. I would say the Maritime Administration assessment is correct. I believe they have reference to a fact which is implicit in my statement but which I did not spell out. For instance, if you route cargo from Japan, to Baltimore via the canal, you have one shipping company that takes care of it.

However, if you route the cargo through Los Angeles and then by rail, you would use another shipping company and a land transportation company. So, there is some transfer of benefits from one group of companies to another.

However, by the same token, the reverse is true with respect to cargo that comes from Europe and goes to the west coast, some is unloaded here on the east coast and proceeds by rail to the west coast. So, there is some counterbalancing effect. But, by and large it is true that an increase in tolls would cause some transfer of benefits among shipping companies.

Mr. METCALFE. On page 8 of your testimony, you discussed what the 1975 sensitivity study projected for a 50 percent toll increase. Under the proposed treaties, we would be talking about 75 to 100 percent increase over the 1974 rates.

What did your 1975 study say about that?

Mr. BRANDES. Our 1975 studies simply said that once tolls were increased from their 1974 level, which was before any toll increase came into effect—once there were increases by as much as 75 to 100 percent—the canal would be getting its maximum attainable revenue.

Any increases higher than that would simply result in losses in traffic growth which are great enough to offset the effect of the toll increase. We said that an increase in the toll rate from 75 to 100 percent was the maximum practical increase in tolls that could be put into effect.

Since then, of course, there have been two toll increases and changes in measurements rules which—in the aggregate—amount to about a 50 percent toll increase.

So, much of this potential increase has already been eaten up by a past increase. How much, we do not know yet, but we hope to learn that from the results of our current study.

Mr. METCALFE. Thank you. I would like to express my appreciation—no, first let me suggest that the staff members starting with Mr. Modglin, and then Mr. Nonnenmacher, and then Mr. Tannenbaum, proceed with their questions, and by that time I will have returned from making this rollcall. Proceed.

Excuse me, that was an adjournment. Thank you very much. I recognize staff member, Mr. Modglin.

Mr. MODGLIN. Thank you, Mr. Chairman.

Mr. Brandes, on page 3 of your statement you have a very important—you make a very important remark there that a toll increase in the range from 25 percent to 46 percent would reduce Panama Canal traffic by percentages ranging from about 3 percent to something more than 20. Is that the initial dropoff or the ultimate dropoff after 5 or 10 years?

Mr. BRANDES. The 20 percent would represent the ultimate dropoff in traffic after 5 or actually 10 years. Yes, sir.

Mr. MODGLIN. Thank you.

This question will be directed to Mr. Steers and Mr. Kujawa. Both the Governor yesterday in his testimony and both of you today addressed a question of what kinds of arrangements should be made to insure that capital or—first of all—that replacement of assets does take place as necessary, and, second, that there be needed capital improvements for the canal.

The question that arises here is who should determine, and how should it be determined, what replacements and what capital are actually necessary? Shouldn't the General Accounting Office and the Congress keep a very close eye on the Commission finances for these two items?

Mr. STEERS. I would certainly expect the Congress and the General Accounting Office to keep an eye on the finances, and they should; but determining the capital requirements, I believe the responsibility must fall first on the Commissioner and his Board of Directors in preparing their capital budget for submission to the Congress.

Mr. KUJAWA. I think the Commission itself ought to be given sufficient operating authority to decide what it needs to operate the canal. The concern of Congress and the GAO should be that the Commission have the wherewithal to self-finance its capital improvements. The oversight function would thus be principally aimed at being sure that the interests of the U.S. Government and, ultimately, the taxpayer, are protected.

Mr. MODGLIN. Finally, Mr. Kujawa, you speak with reference to the payment required under article III of the treaty with respect to public services provided by the Republic of Panama in the canal operating area, and you suggested that a contractual arrangement be made.

Here, we would have the situation in which, if there would be an audit done, the Canal Company would be providing for an audit of services provided by the Government of Panama. Would such an



audit of a government's provision of services be unusual or unprecedented or has it occurred before?

Mr. KUJAWA. In this particular instance, what the Government is doing, of course, is providing services and the services are supposed to be provided based on costs incurred under a contract with another government—the treaty. I think that it is appropriate that in such circumstances, since cost is the basis for payment, that the organization making the payment have the right to determine that the costs have been properly determined.

Mr. MODGLIN. Thank you, Mr. Chairman.

Mr. STEERS. I had some experience on that, Mr. Modglin. When I was with the old "AID" programs some years ago in Europe—in Austria, we obtained the permission of the Austrian Government to have independent audits made on use of some of the U.S. aid to that country by outside auditors.

Mr. METCALFE. Thank you, Mr. Steers, and thank you, Mr. Modglin.

I next recognize Mr. Nonnenmacher.

Mr. NONNENMACHER. Thank you, Mr. Chairman. I have three major questions—maybe four major questions—that I would like all three of you to address yourselves to.

I enjoyed Mr. Steer's terminology of financial horror and organizational morass, and I think the confusion that Mr. Kujawa expressed regarding the so-called contingent \$10 million is something we have to get cleared up.

But, let me start with something that Mr. Steers spelled out, namely that we should turn over the canal operation as a going business, with debts as well as assets. I would like to ask Mr. Kujawa, first, before we discuss that, if you agree with that? I am inclined to think you do because on page 20 of your testimony you indicated that you thought that Panama should be willing to carry on payment of loans if those loans were made for improvements on capital assets that would be for Panama's use, after the year 2000.

Do you differ in any way with Mr. Steers' recommendation?

Mr. KUJAWA. I agree that the canal should be transferred as a going concern. I think that what would have to be done is to establish the Panama Canal Commission as an independent business operation under U.S. management and control until 1999 and that at the time of transfer to the Republic of Panama it would be agreed that the new owner would assume both sides of the balance sheet.

Mr. NONNENMACHER. Mr. Brandes, you did not address yourself to that subject. You limited yourself to answering our questions, but would you comment on this aspect of turning over a canal free of loans and debts, or do you agree with the other two gentlemen?

Mr. BRANDES. I am really not in a position to agree or disagree. I don't have that much knowledge of accounting to speak with any authority on the subject.

Mr. NONNENMACHER. I think many in accounting might feel that this would be a good recommendation and, of course, that would entirely change this significant portion of the treaty.

It cannot very well be done without amending it, and I think your testimony to this end is very important. Now, following up on that, would you, Mr. Steers, and you, Mr. Kujawa, each give me your own

estimate of the canal's debts—well, before you give an estimate, I would like to ask you in what categories would you list this so-called debt that we might pass on, if your recommendations were to be followed, and with which I agree. Second, what would you project that total debt to be as of today, if we were turning it over today; and, thirdly, could you project what it might be in the year 2000? Just rough ball park figures?

First of all, the categories of the debt.

Mr. STEERS. The categories is basically the accounts payable of an organization, the bills you have on hand for operating materials and supplies that you have purchased to operate the canal. It is payroll that is unpaid, but due employees at the end of a period. It is the normal business expenses of any business.

You don't transfer a business anywhere in the world today without passing along its liabilities along with its assets, because it is part of the going life of that business. And, in magnitude, I am not sure what the accounts payable are today—the Governor might know—they are kept rather current, but it could approach \$100 million. I refer only to the general accounts payable. The indebtedness to employees for home leave and for vacation, et cetera—that could be another 30 or more million.

Mr. NONNENMACHER. But you have not included what has already been discussed as a major item, namely the U.S. unpaid investment in whatever way you want to describe it?

Mr. STEERS. The U.S. investment, now that I look at it a little differently but as far as the going liabilities of a business—

Mr. NONNENMACHER. Would you explain your view then?

Mr. STEERS. A lot depends upon ownership of the canal. If the United States maintains its investment in the canal—or whatever it is using—up through the year 2000, it appears to me that at the end of time its investment is just simply written off, no return to the United States on that, no payback.

But, whereas a liability to a businessman for service or good he sold to the canal, that should be passed on to the next operator of the canal. I believe, that if the United States invests into the canal, and continues during the period of the treaty, interest should be paid to the United States during this period on it.

Here are somewhat more accurate estimates: accounts payable at the end of the current fiscal year, total \$67,600,000, made up of accounts payable to other Government agencies of \$5 million; to the business entrepreneur, about \$5 million; \$26 million in employees' leave; \$5 million in salaries and wages to employees; claims against damage to vessels, \$11 million—roughly and payable to the U.S. Treasury, another \$9 million. It might be well to have the Company statement from its financial condition for comparatives for June 30, 1976, September 30, 1976 and September 30, 1977, inserted in the record if you would like.

Mr. NONNENMACHER. I think we should have that, yes.

Mr. STEERS. I appreciate your response. You made a statement in that response that you think that as long as we maintain ownership, which I imagine you feel would be to December 31, 1999—

Mr. STEERS. I'm not sure.

Mr. NONNENMACHER. You are not sure of that?



Mr. STEERS. I think the lawyers are going to have to answer that question. I find the Treaty ambiguous as to who owns the Panama Canal after ratification. I'm not sure we don't give them all the assets, all its facilities, and we just have the right to operate it.

Mr. NONNENMACHER. Well, whatever you feel about that, you did make the statement that as long as we have it, then we should be paying off the U.S. investment.

Apart from this technical matter of ownership, do you feel we should continue doing that until the year 2000?

Mr. STEERS. Yes; I would think so. We should be getting something out of it.

Mr. NONNENMACHER. Following up on that, would you recommend we pay at the same rate that the Company has been paying, or trying to pay, or would you try to do what Mr. Staats referred to yesterday: Pay off the entire investment in the next 23 years? He indicated that it would cause tolls to be raised to provide some \$25 million a year for this purpose alone. Do you think that it is feasible at all for the United States to try to recover its investment in 23 years, at that rate?

Mr. STEERS. I would doubt it. In fact, I'm not sure on that basis that we could add that as a cost. I would have to study that question.

Mr. BRANDES. I would like to make a comment on that, sir, if I may, just as an economist.

I am dubious about the proposition that the U.S. Government should seek to recover the total capital investment in a public work project. It seems to me that the basic economic rationale for public works investment is related to the benefits generated by their construction.

In addition, the recovery by the Federal Government of all capital plus interest invested raises a very serious question as to the eventual ownership of such property. If the users, through their fees have paid both for the capital cost and interests, there is a question as to whether the Federal Government could still regard itself as the legitimate owner of the project. It is my belief, really, that justification—the ultimate justification—for investment in public works has to lie in the benefits generated by it and not simply in the ability or obligation of the enterprise to pay back all of the investment made plus the interest.

I make this comment simply based on my own knowledge as an economist.

Mr. NONNENMACHER. You say this regardless of who owns that utility?

Mr. BRANDES. Yes; well, as long as the—it's U.S. Government property, I think this is what should apply.

Mr. NONNENMACHER. Even if that might be accepted, generally, in this case the utility is passed from U.S. ownership to that of the Republic of Panama, and I wonder, would that make any difference in your observation?

Mr. BRANDES. This to me becomes a matter that has to be settled as part of the treaty, if it is to be settled anywhere.

Mr. NONNENMACHER. Thank you very much.

Mr. KUJAWA, do you care to comment on this last matter we have been discussing? Regardless of the question of trying to recover our investment before we phase out ownership.

Mr. KUJAWA. I address the subject directly in my testimony. The treaty imposes significant additional costs on the Panama Canal Com-

mission. If on top of that, the U.S. investment, I'm not sure whether that wouldn't create an impossible situation where tolls couldn't possibly be raised sufficiently. Possibly, if you did try to raise tolls to that degree, the disruptive aspects of an increase of that magnitude would be such a disadvantage to the United States that we might not want to do it. Also, looking at practicalities here as opposed to theory, I am not sure whether the United States could recover its investment within the next 20 years even if such an objective were adopted.

Mr. NONNENMACHER. All right. Let me go to an item that I am not certain of myself. The question is raised in my mind in view of what you have suggested in your testimony, Mr. Kujawa.

Is there anything in the treaty that prevents the Commission from seeking to make a profit, or is it spelled out that it is to be merely a breakeven operation, such as is the case with the present Canal Company?

Mr. KUJAWA. No, the treaty doesn't prevent it, but under the provisions of article XIII(4)c, if the Commission does make a profit, the first \$10 million automatically goes to the Republic of Panama. So, the only chance the United States would have to realize receipts from canal operations would be after the annual \$10 million payment, and if the payment is not made annually, this requirement becomes cumulative.

The prospect for the United States receiving any cash out of the enterprise, I think, is fairly remote.

Mr. NONNENMACHER. You raised this question in my mind by talking about the possible use of a surcharge. If the treaty has no language that prevents it from making a profit, it certainly has no language preventing it from setting the tolls at any rate you want, including the purpose you called for, a surcharge. So, why have a surcharge? Why have a base toll and add a surcharge? Why not set a basic toll, high enough to include the basic requirements?

Mr. KUJAWA. The basic toll should have a reference point based on established policy which everyone understands. This reference point should be the cost of providing the service. As I indicated in my formal statement, the determination of this cost should be based on generally accepted accounting principles. Due to the need for capital funds, it may be necessary to have something over and above that basic toll which I refer to as a surcharge. This surcharge should be separately determined and justified, that the surcharge is for capital improvements and doesn't constitute profits. If it were considered profit or surplus, then the surcharge would go over to Panama to the extent of the first \$10 million and money would not be available to make the capital improvements. The intended objective would then not be achieved.

Mr. NONNENMACHER. I appreciate that, but why call it a surcharge? Capital improvements are part of your basic cost. Since we have to have implementing legislation for the treaty, and there is no law at present to take care of running this operation under the Commission, why not set it up that way? You are stating your premise from your generally accepted accounting principles, I am sure.

Mr. KUJAWA. I am looking at the surcharge—the capital surcharge—as a cost that the Commission is incurring, a cost to make a



capital improvement, and is attempting to finance it through user charges. So, the Commission then would say to the users:

Look, we have got \$15 million worth of improvements to make here and we need the money to do it and we will charge you \$15 million over three or five years, and after we get it, we will take the surcharge off.

It is not a profit. It relates to specific costs which the Commission can point to and the user can see as it is constructed.

Mr. NONNENMACHER. On a one-shot basis, as it were, and just for occasional capital improvements as is necessary.

May I ask you, Mr. Kujawa, in your prepared testimony, have you had a chance to read the State Department's prepared answers to our questions regarding article XIII(4) c?

Mr. KUJAWA. No. I have not.

Mr. NONNENMACHER. I don't know if we should take the time to go over that, Mr. Chairman. There are several pages. The answers are short, but they might be clarified. Maybe I can read one or two of these brief answers.

Mr. METCALFE. We are short on time. If we are going to get to the next panel—well, very quickly, go on, Mr. Nonnenmacher.

Mr. NONNENMACHER. I appreciate that. We will let that go, but I would like to have you submit in writing your own thinking—if you remain confused after reading the State Department's answers on whether or not these obligations are cumulative and, in fact, can be demanded by Panama in the year 2000. I think we should have that.

Mr. KUJAWA. I will be happy to.

Mr. NONNENMACHER. After reading it I am still not certain. Thank you very much.

Thank you very much, Mr. Chairman.

Mr. METCALFE. Thank you, Mr. Nonnenmacher. Now we recognize Mr. Bernie Tannenbaum.

Mr. TANNENBAUM. Thank you, Mr. Chairman. Mr. Brandes, on page 3 of your statement you indicate a new tolls increase would "reduce Panama Canal traffic" from about 3 percent on a 25 percent tolls increase to 20 percent on a 46 percent tolls increase; however, you state that at 24 to 46 percent tolls increase would involve a delivered cost increase of less than 1 percent.

Does this 1 percent include and contemplate a loss in revenues from a potential disastrous drop of 20 percent of canal traffic and the effect on the canal as a financial viable entity?

Mr. BRANDES. Perhaps I might clear up my percentages in the way they are used. The 1 percent refers to the portion which Panama Canal tolls represent the cost of commodities shipped through the canal, whether manufactured, or raw materials—like coal and grain.

A 25 to 46 percent toll increase would not, with very few exceptions, increase the delivered price of the commodity, by more than 1 percent, and in most cases, the increase would be only a fraction of 1 percent.

Now, the fact that these very small total price increases for the products involved would result in diversions from the canal of fairly sizable percentages, is a clear indication that many users of the canal have alternatives available to them, which, in terms of cost, come very close to using the Panama Canal.

So, this is the way in which these percentages should be used.

Mr. TANNENBAUM. I understand that, but what I am trying to point out is the increase which causes the diminution of use of the canal then creates other problems where you have to increase tolls further to make up the diminution, so 1 percent becomes a cumulative problem.

Mr. BRANDES. Well, the point here is up to increases in toll rates of 100 percent, based on the study we did in 1975, a toll increase will result in increased revenue. It may reduce traffic, not necessarily from last year, but from the forecast levels that were projected for future years—but each increase in toll rates in the past did result in increases in revenue.

You don't get to an area of diminishing returns until you get to increases of more than 100 percent. Then you begin; first, to tread water, so-to-speak, where increases in toll rates simply produce no additional revenue and after that, you finally get actual declines in revenue with each further increase.

Mr. TANNENBAUM. But, aren't we now in areas of diminishing returns, if you are going to saddle the canal with an additional 40 percent—you say 50 percent already has been eaten up in 1974, and in 1976. If we add another 40 percent to that, your arithmetic said 75 to 100 percent—so we are up to 100 percent.

Mr. BRANDES. We are getting into that range.

Mr. TANNENBAUM. It is a very serious problem.

Mr. BRANDES. We are in the range—getting close to the range of maximum attainable revenue.

Mr. TANNENBAUM. On page 3 you state that U.S. business and consumers are ultimate payers of about one-third of all tolls. Does this include additional toll charges to the U.S. military vessels?

Mr. BRANDES. Yes.

Mr. TANNENBAUM. You did consider that.

With regard to American exports, you state on page 4, and I am quoting: "The exporting companies are the ultimate payers of any increased tolls."

Mr. BRANDES. In general.

Mr. TANNENBAUM. Once such increase—I'm glad you answered that generally—because won't these increases have an effect on U.S. business as a negative balance of payment, if the United States loses business as a result of such toll increase?

Mr. BRANDES. We have not been able to identify a single commodity export from the United States in which toll increases in the range to be considered here would result in any measurable decline in the volume of U.S. exports. We have been able to show that in some cases it would result in a rerouting of the export. With respect to some imports, we have been able to identify situations where there would be what we call a change of sources and markets.

One way in which use of the canal can be avoided is, for instance, for Peruvian iron ore producers to stop selling iron ore to the United States, but to sell it instead to Japan, and the United States buys its iron ore either from Brazil or internally or from Canada. Everyone is satisfied, except that transit through the canal has been avoided.

Now, we have been able to identify such situations, but have not been able to identify situations in which the volume of U.S. exports would be decreased as a result of toll increases being considered here.



Mr. TANNENBAUM. Of course, with that response—that would apply no matter what the increase—I mean there has to come a point where we become noncompetitive, isn't there?

Mr. BRANDES. We have not been able to identify that.

Mr. TANNENBAUM. If rerouting occurs and cargo goes from the United States to foreign-flag vessels in U.S. trade, isn't this a balance-of-payments effect?

Mr. BRANDES. Pardon me, sir. I did not understand the full question.

Mr. TANNENBAUM. If there is a rerouting and cargo goes from the United States to foreign-flag vessels in U.S. trade, then doesn't this create a balance-of-payments effect?

Mr. BRANDES. Well, only rerouting away from the U.S.-flag vessels that we have been able to observe—not so much as a result of Panama Canal toll increase, but as a result of natural developments—has been the decline in U.S. intercoastal trade, which by law, has to be carried in U.S.-flag ships. We believe most of this increase has to do with normal competitive forces within the transportation industry.

For instance, once upon a time, as you probably know, there was a great deal of lumber shipped from the west coast of the United States through the canal to the east coast. This trade has entirely disappeared—not because of any toll increases, but because most of the lumber mills located on the coast have closed down. The industry has moved further inland and has changed from shipping by ships to shipping by rail.

This was a natural development, but obviously, it did U.S.-flag shipping good, because most of the ships involved had been U.S.-flag ships. But I have not been able to see where the Panama Canal itself played any role in this decline, because the losses occurred before the first tolls increase was ever put into effect.

Mr. TANNENBAUM. Since you indicate on page 5 that the impact of the tolls increases are not fully felt for 5 to 10 years, then isn't it apparent that we have not yet even seen the full impact of the 1974 and 1976 tolls increases?

Mr. BRANDES. That is correct, sir.

Mr. TANNENBAUM. Yet, the treaties contemplate substantial new increases of approximately 40 percent. Do you think an increase in the tolls of approximately 40 percent by reason of the treaties, coupled with the 1974 and 1976 increases, and the loss of Alaskan oil in 1980 will spell out the demise of the canal as a financially viable entity, especially in view of additional costs in connection with the new treaties?

Mr. BRANDES. Well, obviously, many things could happen in the future. I happen to be something of an optimist and while I do regard the future for the canal, economically speaking, very challenging—to say the least—I certainly would not regard it as hopeless.

Mr. TANNENBAUM. How about Mr. Steers. Could you respond to that question?

Mr. STEERS. I personally have serious concerns about the financial viability of this canal, as I look to the future. I think the inflationary impacts alone on costs will be in themselves just difficult to keep up with in rate increases.

Its additional costs, the fact that the canal is economically mature, and the projections by the economists are not overly optimistic. It just

shows a relatively modest growth. I think the future could well be one of continuing financial struggle.

Mr. TANNENBAUM. Mr. Steers, I notice that you talk of loans to the canal entity, which might be payable beyond the year 2000. I want to point out to you that the treaties do not permit these. The treaty provides that we must turn the canal over, free from all debts, so it would require a change.

Mr. STEERS. I think that is ridiculous. I have a possible alternate, that say, beginning with 1990 Panama become the lender for capital improvements.

Mr. TANNENBAUM. We have the treaty documents. Unless they are amended to contain language to effect that, we are saddled with that, and unless the treaty is amended, we have no alternative here. How do you create language to implement something that can't—

Mr. STEERS. Perhaps in the future, when they negotiate such type treaty, they should have a financial man as part of the team.

Mr. TANNENBAUM. Mr. Kujawa, did you tell us what the critical point is—that is: What percentage of increase in traffic can the canal take before it ceases to be a viable entity?

Mr. KUJAWA. Well, based on the prospects for increases of the toll rates, which Mr. Brandes testified to briefly, the Panama Canal, because it is going to have cost increases, must have traffic increases to remain viable.

It is unlikely that the canal can remain viable if traffic were to decrease, so it is going to have to have increases.

Mr. TANNENBAUM. All right. Just a couple of quick questions. Mr. Brandes, and Mr. Kujawa, do you agree with Congressman Murphy and Mr. Steers that unless the financial and other aspects of the treaties are clarified, they are likely to be a breeding ground of conflict and adversity as stated by Mr. Steers, or will create more problems than they will solve, as stated by Congressman Murphy.

Mr. Kujawa, do you care to comment on it? Do you agree with those statements?

Mr. KUJAWA. The treaty is very broad as to financial matters, so that clarification in some form is necessary.

I have testified in my formal remarks on the areas in which there seem to be ambiguities that require resolution.

Mr. BRANDES. I would simply say that while I recognize, along with many other people, that there are probably a great many ambiguities in the treaty documents as it exists at the present time, it does seem to me that there is a potential here for a community of economic interests, so-to-speak, on both sides. Both the Americans and the Panamanians, as far as the future is concerned, are interested in the survival and good economic health of the canal and that in itself perhaps may be a mediating influence to the resolution of these difficulties.

Mr. TANNENBAUM. Finally, Mr. Steers and Mr. Kujawa, would you care to comment on the following statements relating to the treaties:

All payments are to come from canal revenues and have been set at levels which the canal enterprise should be able to generate.

The next statement:

The treaties have been designed to assure Panama a just and equitable share of the benefits derived from the operation of the canal.



Do you believe that the treaties cover these points?

Mr. STEERS. I would say that the person who made those statements should be asked to provide the justification for them.

Mr. TANNENBAUM. These statements were made yesterday by Ambassador Bunker.

Mr. KUJAWA. As I indicated in my testimony, to date I have not seen a comprehensive study that shows that the Panama Canal Commission, looking over a horizon of several years, can itself generate these payments to Panama.

Now, there are statements that it can do it, but I guess, as an accountant, I would like to deal with facts and I have not yet seen sufficient supporting evidence in this regard.

One of the biggest inputs to this process will be the study by Mr. Brandes regarding traffic forecasts and ability to raise tolls. Until you know that, I don't know how you can know that the Panama Canal Commission can be viable.

Mr. TANNENBAUM. Thank you very much, Mr. Chairman. I'm sorry I took so much time.

Mr. BRANDES. I just wanted to make one comment on the question of forecasting traffic, because I think it is important. All of us who are in the business of trying to make forecasts have to work under a handicap when it comes to make very long-range forecasts, and the particular forecast we are working on at the present time covers a time span of more than 20 years.

The problem we have is that we can see the rise and fall of what exists presently but we cannot see things that have not yet come upon the horizon. Let me cite an example: We did an analysis of the portion of 1977 Panama Canal traffic that could not have been forecast in 1955, which is the same kind of time span we are looking at if we tried to project traffic to the year 2000. We came to the conclusion that something close to 27 percent of the current traffic could not have been forecast in 1955 because it did not then exist, even in the embryo form, so-to-speak.

One example is automobile exporters from Japan. In 1955 there was no evidence whatsoever that the Japanese would be capable of developing an automobile industry for their own use, not to speak of an export industry. We could not have forecast that. So, I simply want to cite that—that it is in the nature of the problem that we are not capable of seeing some of the good things that the future might hold.

Mr. TANNENBAUM. We understand that and I think that Congressman Murphy pointed that out too. Perhaps we should get Jeanne Dixon here as a witness to forecast the future.

I believe that Mr. Whitman had a couple of questions.

Mr. WHITMAN. Mr. Steers, I would like to ask for one clarification on your testimony. I know what you meant, but I want it to show on the record. Toward the end of your testimony, you said that the Company should have an arrangement similar to the present one under which they do not obtain appropriations. I assume you mean that they don't get an appropriation of new money, not generated by the operations of the Company, but in view of the provisions of the Corporation Control Act that the budget program must be submitted to the Congress and that the Congress must enact appropriations making

funds of the corporation available or whatever the Congress chooses to include?

Is that a reasonable construction of your testimony?

Mr. STEERS. Yes, sir.

Mr. WHITMAN. I have one other question for Mr. Steers or for Mr. Kujawa.

On the role of depreciation accounting, depreciation accruals and relationships if any of the depreciation accruals to capital replacement: My question is, are depreciation accruals necessarily earmarked for investment in capital replacements?

Mr. KUJAWA. They should be considered separately. Depreciation is the accounting process to properly recognize the cost being incurred to conduct the business for the period. The question of whether or not you ought to replace the asset in kind or a different asset is a separate question.

Mr. WHITMAN. This question relates to article XIII(4) c. of the treaty and possible construction of the provisions of that paragraph that the depreciation accrual could be retained for capital replacements and not used for the payment of that second \$10 million to Panama?

Mr. KUJAWA. Yes; I look upon that as being the case—that the depreciation costs represent for the Panama Canal Commission that level of capital necessary to sustain itself.

How you go about replacing the asset is a separate question, but you better, through tolls, get the wherewithall and recognize as a cost the consumption of assets that have to be replaced in order to sustain the business.

Mr. WHITMAN. Two very short questions: What is the basis of collection of interest in the present tolls formula?

Mr. KUJAWA. The basis is the 1950 statute establishing the Panama Canal which indicates that the Panama Canal Company should be responsible for all costs of providing service to world shipping and all costs include, properly, in my judgment, the cost of capital.

I don't think you can go in any bank and borrow money without paying interest, and similarly that is what was provided for in the establishment of the Panama Canal Company. Tolls are set to recover all costs, including the cost of that capital.

Mr. WHITMAN. One last question to Mr. Brandes. Yesterday we heard some testimony indicating that the effect of tolls increases in the range of 25 to 46 percent would disappear within a few years if no further toll increases were made. Could you comment on that?

Mr. BRANDIES. No; according to our studies, this would not be the case. As a matter of fact, we believe the effect of a toll increase tends to increase for at least 10 years. This is a very important consideration because in the short run it may appear that the Company could get away with a rather large increase, because in the short run, most shippers would have few alternatives other than paying the toll.

But, it is in the long run, that the alternatives develop and in the long run that the major effect of the toll increase is felt.

Mr. WHITMAN. Thank you, Mr. Chairman.

Mr. METCALFE. Mr. Nonnenmacher, would you please proceed?

Mr. NONNENMACHER. Yes; I would like to ask one quick question. As you recall from the hearings we had on the Panama Canal finan-



ces a year ago, there was enormous attention paid to the new depreciation put into effect by the Company in 1973 or 1974. That led to paper losses of some \$8 to \$10-million a year, red inking the accounts of the Company. You have discussed with us today measures which you believe should be taken on behalf of the Panama Canal Commission more or less in terms of new items.

Do you see anything that might have to be done by changing present operations, such as that depreciation which would have been disallowed by a bill that did pass the House of Representatives—one that came out of this committee. In other words, would the depreciation on titles, treaty rights and excavations continue since that incurs such a cost in the balance sheet?

Mr. KUJAWA and Mr. STEERS, would you address yourselves to that, please?

Mr. KUJAWA. Well, the depreciation policy that the Company currently follows is pursuant to the current law. The Panama Canal Company is responsible for recovery of the investment of the U.S. Government in the enterprise and the depreciation follows that.

If you establish the Panama Canal Commission and you say: "Look, we, the U.S. Government, don't intend to recover the investment," then, the depreciation assumption would be different and in that case, the depreciation on the excavation of the original canal would probably not be appropriate.

Mr. NONNENMACHER. Mr. Steers?

Mr. STEERS. I would agree with Mr. Kujawa. However, if the ownership of these assets are transferred to the Commission and it is retained by the U.S. Government, I believe these assets should be depreciated. You have the alternate of some legislative action that would eliminate the depreciation from them, if you wished. But you are still faced with the problem of finding a way of financing capital improvements. Without a cash flow from operations to assist in financing capital improvements, the canal would be in a serious situation.

Mr. NONNENMACHER. I thank you very much. Let's look again at that figure of the current accounts payable, the debts of the Company. If we do follow the treaty language, and there is no amendment, and we do turn over the operation free of liens and debts, how would we dispose of the \$67,600,000, assuming that would be the same figure as of that time? Would borrowing from the Treasury perhaps take care of it, and if so, would the Treasury have to replace that money by floating notes or bonds at interest?

What I am trying to get at is this, would the elimination of that liability as of a certain date—the last day of December 1999—would that bring about any new costs to the American people?

Mr. STEERS. It would appear that the American taxpayer would have to pay the just debts of the Panama Canal necessary to make it an operating institution.

Mr. NONNENMACHER. It just occurs that we have already incurred the debt. Are you saying that we have not yet raised the money to pay the debts, so that if we turn the canal over to Panama free of debts, we then have a new case of some \$67 million, assuming the figure stays the same?

Mr. STEERS. The Commission incurred the debt because someone has furnished service or material to the Panama Canal. That individual

has to be paid, or those individuals have to be paid. If, in the year—December 31, 1999, the figure is \$60 or \$70 million, in those outstanding debts, I would presume—and they had to be liquidated—I would take all the cash balances of the Panama Canal and apply them against that debt and have to go to the Congress, I imagine, to get additional funds to make the complete liquidation.

Mr. NONNENMACHER. So you would categorize it as another cost of the treaties, if we turned over the canal operation free of debt?

Mr. STEERS. Yes, sir.

Mr. NONNENMACHER. Would you agree with that, Mr. Kujawa?

Mr. KUJAWA. The treaty language says: "Unless otherwise agreed," and I suppose if I was managing the financial affairs in 1999, I would attempt to minimize that by agreements with Panama or, if I couldn't get agreements, I might not order inventory received in 1999 that has to be paid for in the year 2000. I think that assuming that we have a reasonable relationship with the Republic of Panama at that time, we could work out ways in which this amount could be minimized and/or eliminated.

Mr. STEERS. Don't overlook the fact that this is an immediate problem. If you are turning over the commissary or the railroads or the piers, they have accounts receivable too, accounts payable. They have business debts at this point in time.

I believe they too should be turned over as a going business. There should be no liquidation of business related debts on the part of the United States before the transfer is made.

Mr. NONNENMACHER. I appreciate your testimony because I think that in view of the fact that we have been told that the taxpayers will not be subjected to another cent of cost as a result of these treaties—it is very important to have this discussion on the record.

Thank you, Mr. Chairman.

Mr. METCALFE. Thank you, Mr. Nonnenmacher.

Mr. Brandes, I understand you were somewhat involved in the economic part of the negotiations. Did you not meet with Minister Barletta of Panama; did you deal with him at all, and if so, what is his attitude towards the canal tolls?

Mr. BRANDES. My answer, sir, is that yes, I was involved in the Panama Canal negotiations and I did meet Mr. Barletta in one meeting that was attended by, I would guess, about six or eight other people.

My role in that particular meeting was to set forth my own conviction concerning the economic value of the canal or, in other words, the additional revenue potential that might exist, also to express my concern that trying to achieve more in revenue, than the canal could sustain over a long period of time, would run the danger of killing off the goose that laid the golden eggs. That was the extent of my contact with Mr. Barletta. I have been led to understand, subsequently, that apparently the Panamanian delegation did become convinced that the financial potential of the canal was far, far less than they had originally believed, and which was apparently reflected in their original demands.

Mr. METCALFE. Thank you. The chairman makes unanimous consent to put the financial statements which were mentioned by Mr. Steers into the record. Hearing no objection it is so ordered.



[The documents were not available at time of printing.]

Mr. METCALFE. I ask unanimous consent to provide all the additional questions that we would have asked the panel for the record and submit them and have them answered for the benefit of the record. That will then be so ordered.

I would like to thank this very distinguished panel for their very cogent testimony. You have the thanks of the entire committee. Thank you very much.

I would like to make an announcement. We will hear from one more panel and then recess for lunch. The panel on International Law and User Guarantees under the proposed treaties consists of Prof. Richard Baxter of Harvard Law School and Charles Maechling. Professor Baxter is one of our country's top experts on the law of international waterways. He has written one major book on that subject and has written extensively on the Panama Canal and other international waterways.

Mr. Maechling is now with a Washington law firm and has written on the Panama Canal Treaty and the proposed treaties. Mr. Maechling is a former State Department official and he is a professor of international law. He has knowledge of a whole spectrum of international maritime and oceanic matters.

In the event that the audience is wondering why we brought in the international law specialists in this particular hearing, the purpose is to relate the financial matters under the proposed treaties to the standards of law that may prevail in our world.

Gentlemen, given the fact that each of you have responded to our questions directly in your testimony, would it be appropriate to ask each of you to make an introductory type remark. Then we can go through the questions one by one as counsel will read them, or summarize each question. Then each of you can read or summarize or expand your testimony to that question. After we have gone through the questions of the subcommittee, members will propound their questions.

May I have your introductory remarks, gentlemen?

#### STATEMENT OF RICHARD R. BAXTER, PROFESSOR OF INTERNATIONAL LAW, HARVARD LAW SCHOOL

Mr. BAXTER. Thank you, Mr. Chairman. I am Richard Baxter, professor of law at Harvard University, editor in chief of the American Journal of International Law, and former president of the American Society of International Law. What knowledge I do have of this matter relates to its international law aspects.

I think it proper to disclose that I have in the past rendered legal services to a company having an interest in Panama Canal tolls and with regard to those tolls, but I am not at the present time retained by any such client.

I have, as you know, sir, submitted a statement of some 30 pages for the subcommittee's consideration and, mindful of the injunction that I was to speak for no more than 10 minutes and being a strict constructionist, I shall be very brief.

My first assumption is that the Panama Canal is free and open to ships of all nations by dedication to international use in 1901 and 1903.

My further assumption is that all states have an enforceable right to use the canal, despite the statements to the contrary made by Secretary of State Hughes and Secretary of State Dulles.

What it seems to me that the old treaties do, and what the new treaties will do is to spell out the details of this regime whereby the Panama Canal is laid free and open to use by the ships of all nations.

A second point: The term neutrality is in my view a misleading expression. The fact is that Panama and the United States can close the canal if Panama or the United States should be at war. They can defend the canal and, without considering the legalities, one might expect that adversaries of these two countries might attack the canal.

It is not neutralized territory in the sense in which that expression is used in international law. What I suppose neutrality really means is that, when the United States and Panama are not involved in a conflict and the canal is used by the shipping of belligerents, these ships are supposed to behave themselves while in the canal and not to engage in acts of hostility.

The subcommittee, I know, is particularly interested in the question of the tolls formula, and this will be my third point. The terms of the old treaties were that the tolls were to be "just" and "equitable." It is not quite clear what those terms mean. They certainly leave a great deal to the judgment of the particular decisionmaker.

We now have added to those two expressions two further ones. The tolls must be "reasonable" and must be consistent with the principles of international law. The term reasonable suggests to me some sort of objective standard that is to be applied.

I am less clear about what consistency with the principles of international law may mean. What it seems to mean mainly is that we can draw upon precedents derived from other oceanic canals such as the Suez and the Kiel Canals. It does draw in, certainly, a wider range of considerations than was possible before, when the standard was one that the tolls had to be just and equitable.

The problem, as I see it, of trying to be more specific as to the appropriate level of tolls is that one would have to go into very much more detail. Over the remaining life of the treaty, and after the year 2000, one might suppose that these detailed provisions would turn out to be much too rigid and indeed not suited to the needs of the canal or its users.

My fourth and final point relates to what seems to me to be a defect in the instruments. There is no procedure under these agreements for compulsory dispute—settlement from the perspective of international law. Now, the United States has made third party dispute-settlement one of the cardinal principles in our position with regard to the law of the sea negotiations. The United States has not included and the Republic of Panama has not included any provision for compulsory third-party dispute-settlement in the new Panama Canal treaties.

Let me be specific about this. If passage through a strait is impeded, under the new Law of the Sea Treaties the United States will have the right to resort to a tribunal to maintain its right of transit passage through that strait. On the other hand, if passage through an artificial strait—the Panama Canal—should be impeded, there would be no way in which the user state, to which position the United States is



quickly passing, would be able to enforce its right against what will be the new proprietor of the Panama Canal—the Republic of Panama.

Egypt has accepted the compulsory jurisdiction of the International Court to a limited extent with respect to complaints by users of the Suez Canal about violation of the regime of the canal. The United States and Panama should be prepared to do no less. This could be accomplished by a declaration, jointly or separately, by which the two countries would accept the compulsory jurisdiction of the International Court as to disputes arising out of the application or interpretation of the new Panama Canal treaties and would accept the jurisdiction of the Court as to actions brought by any user state.

This would not call for any revision of the existing treaty texts. This would merely be a new declaration to the world and to the International Court of acceptance of the jurisdiction of that Court in connection with disputes about the canal. This would be a way in which to enforce the rights of users and, more particularly, to enforce the rights of users to just and equitable and reasonable tolls which are consistent with the principles of international law.

Thank you, Mr. Chairman.

[The following was accepted for the record:]

#### STATEMENT BY PROFESSOR R. R. BAXTER, HARVARD LAW SCHOOL

My opinion has been requested with respect to a series of questions relating to the economic and financial ramifications of the proposed Panama Canal Treaties. I shall respond to these questions individually.

1. How do the international legal guarantees now provided users of the Canal compare with the guarantees provided in the proposed Treaties? For example, what becomes of the six rules under the Hay-Pauncefote Treaty? Article III(c) of the Neutrality Treaty indicates that 'tolls and other charges for transits and ancillary services shall be just, reasonable, equitable, and consistent with the principles of international law.' What does 'reasonable' mean in this context? What effect do these constraints have if the new treaties enter into force?

The legal guarantees now afforded to users of the Canal are to be found in Article III of the Treaty between the United States and the United Kingdom to Facilitate the Construction of a Ship Canal of 1901 (the Hay-Pauncefote Treaty), as incorporated into the Isthmian Canal Convention between the United States and Panama of 1903 (the Hay-Bunau-Varilla Treaty) by Article XVIII thereof. The rights of users under the Treaties of 1901 and 1903 and under the proposed Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal fall in the following categories:

##### A. NEUTRALIZATION OF THE CANAL

The Hay-Pauncefote Treaty states that the rules in Article III of that Treaty are on the basis of the "neutralization" of the Canal, while the Hay-Bunau-Varilla Treaty provides that the Canal \* \* \* shall be neutral in perpetuity."

The new Neutrality Treaty contains a declaration by Panama in Article I that 'the Canal, as an international transitwaterway, shall be permanently neutral in accordance with the regime established in this Treaty.' Under Article IV, "The United States of America and the Republic of Panama agree to maintain the regime of neutrality established in this Treaty, which shall be maintained in order that the Canal shall remain permanently neutral, \* \* \*"

The regime of permanent neutrality established by the Treaties of 1901 and 1903 is maintained and confirmed in the new Neutrality Treaty.

##### B. THE CANAL TO BE FREE AND OPEN

Rule 1 of Article III of the Hay-Pauncefote Treaty provides that "The canal shall be free and open to the vessels of commerce and of war of all nations observing these Rules." Under Article II of the new Neutrality Treaty, the neutrality of the Canal is declared "in order that both in time of peace and in

time of war it shall remain secure and open to peaceful transit by the vessels of all nations," subject to four lettered requirements concerning payment of tolls and other charges, compliance with applicable rules and regulations, and a duty not to commit acts of hostility within the Canal, as well as other conditions and restrictions established by the Treaty.

It will be observed that the formula of 1901 and 1903 is that the Canal is to be "free and open," while the Neutrality Treaty stipulates that it is to be "secure and open." Some refinement of meaning was undoubtedly intended, but the nuance is of the kind that means much more to the negotiators than to those to whom the Treaty is directed. "Free" does seem to provide greater security to the user than does "secure," which places emphasis on the interests of Panama, although it may be contended that the security of the Canal is likewise intended for the benefit of users.

#### C. EQUALITY AND NON-DISCRIMINATION

The Canal, under the Hay-Pauncefote Treaty, is to be free and open "on terms of entire equality, so that there shall be no discrimination against any \* \* \* nation, or its citizens or subjects, in respect of the conditions or charges of traffic, or otherwise." The neutrality of the Canal is declared by Article II of the Neutrality Treaty in order that the Canal may be open to "peaceful transit by the vessels of all nations on terms of entire equality, so that there shall be no discrimination against any nation." The obligation of Panama appears to be the same under both the Neutrality Treaty and under the Hay-Bunau-Varilla Treaty, which incorporated by reference the Rules laid down in the Hay-Pauncefote Treaty.

#### D. THE JUSTICE, REASONABLENESS, AND EQUITABLE CHARACTER OF THE RULES OF TRANSIT

Rule 1 of Article III of the Hay-Pauncefote Treaty provides that the "conditions and charges of traffic shall be just and equitable." Paragraph 1(a) of the Neutrality Treaty stipulates that the "Canal shall be operated . . . in accordance with conditions of transit through the Canal, and rules and regulations that shall be just, equitable and reasonable, and limited to those necessary for safe navigation and efficient, sanitary operation of the Canal." The interests of users appear to be given greater protection by the broadening of the language to include the concept of "reasonableness" and by placing a limitation on the purpose for which the rules are promulgated to "safe navigation and efficient, sanitary operation of the Canal."

#### E. STANDARDS FOR TOLLS

Under the Hay-Pauncefote Treaty, "charges of traffic shall be just and equitable," while under the new treaty, "Tolls and other charges for transit and ancillary services shall be just, reasonable, equitable and consistent with the principles of international law."

The proliferation of detail in the new Neutrality Treaty, in particular the requirement that tolls and charges be "reasonable" and "consistent with the principles of international law," enhances the protection of the rights of users. The term "reasonable" imparts a greater objectivity to the standard than is provided by the terms "just" and "equitable." "Just" is the vaguest of the terms. "Equitable" might be taken to mean equitable to the territorial sovereign of the Canal, Panama, or may have some of the coloring of non-discriminatory. The standard of reasonableness is an objective one, commonly employed in connection with rate regulation, and is more weighted toward the interests of users than are the terms "just" and "equitable."

The requirement of consistency with "the principles of international law" has the beneficial effect of permitting the parties to a dispute or a third-party decisionmaker to invoke precedents in the form of arrangements made with respect to other international waterways, particularly interoceanic canals. The international law is not clear and firm, and any attempt to articulate it must be in a certain measure *de lege ferenda*. In R. R. Baxter, *The Law of International Waterways* 268 (1964), the following conclusion was reached:

It is, however, safe to conclude from this limited evidence of the law that no objection, grounded in customary or conventional international law, could be raised to tolls designed to provide sufficient funds for reimbursement of costs of capital, provision of necessary reserves for improvements, depreciation, and costs of current operation and maintenance. If tolls were to be set at a level high



enough to provide in addition for the return of capital invested, the question might well be raised why the operator or proprietor of the canal should receive repayment of these costs while retaining the facilities. Nevertheless, neither customary nor conventional international law appears to provide a basis for challenging tolls reflecting return of capital. It is submitted, moreover, that charges for such a purpose are proper. They would reflect the fact that the waterway is permanent in nature, has as its purpose the provision of a public service, and is not held as an asset for possible sale on the market. Once invested capital had been returned to the entity furnishing it, it would follow that no case could be made for retaining tolls at a level dictated by the necessity of securing sufficient funds to permit payment of costs of capital and return of capital. A corresponding reduction in tolls would thus be in order.

And in the draft "Articles on the Navigation of International Canals" which concluded that book, it was urged that the territorial sovereign has the obligation:

(d) To maintain tolls at a reasonable level, without discrimination between States, such tolls to be fixed with regard to the need of: (1) covering the costs of current operation and maintenance and depreciation, (2) meeting the costs of capital, (3) provision of necessary reserves for improvements, (4) repayment of the capital investment, and (5) provision of a reasonable return on the investment represented by the canal.

(Id. at 345.)

The "costs of current operation" would include the payment of thirty cents per Panama Canal net ton and the fixed annuity of \$10,000,000, to be paid by the United States to Panama under the terms of paragraph 4 of Article XIII of the New Panama Canal Treaty. Presumably, the further payment of \$10,000,000 to Panama out of that excess of revenues over expenditures of the Panama Canal Commission, as provided in subparagraph 4(c) of Article XIII, would be attributable to the "reasonable return on the investment represented by the Canal" referred to in the draft Articles above.

#### F. ANCILLARY SERVICES

The new Neutrality Treaty includes a rule that "Ancillary services necessary for transit through the Canal shall be provided," which has no counterpart in the Hay-Pauncefote Treaty.

There are other provisions of the Treaties of 1901 and 1903 and of the new Neutrality Treaty that relate to obligations to permit the passage of warships and auxiliary vessels, but it is understood that the passage of merchant ships is the primary concern of the Sub-Committee and nothing further will be said on warships and auxiliary vessels.

When the new Panama Canal Treaty and the Neutrality Treaty enter into force, the Isthmian Canal Convention of 1903 and the subsequent treaties and agreements on the Panama Canal between the United States and Panama will be terminated under Article I, paragraph 1, of the Panama Canal Treaty. However, the Rules in Article III of the Hay-Pauncefote Treaty will not be terminated, since treaties between the United States and Panama cannot have the effect of terminating a treaty between the United States and the United Kingdom.

It appears that the United States will be under an obligation to apply the provisions of the new Neutrality Treaty in the transitional period, even though the governing rules are, in the terms of the treaty, declared by Panama. The United States has under Article IV agreed "to maintain the regime of neutrality established in the Treaty, which shall be maintained in order that the Canal shall remain permanently neutral, notwithstanding the termination of any other treaties entered into by the two Contracting Parties." It thereby appears to have accepted the duty to apply the rules in the Treaty for the transitional period.

When the rights of the United States terminate on December 31, 1999, its responsibilities for the operation of the Canal will terminate and its duties under the new Neutrality Treaty and under the Hay-Pauncefote Treaty with the United Kingdom will be without object. These duties will likewise terminate at that time.

In the transitional period, the United States will thus be bound to apply both the new Neutrality Treaty and the Hay-Pauncefote Treaty. As has been shown, the terms of the two treaties are not identical, and problems could arise from the compliance of the United States with one but not the other. Presumably, a third state, being the beneficiary of rights as a third party under both treaties, could invoke whatever provisions might be more favorable to it.

2. What is the effect of the provisions of the Hay-Pauncefote Treaty and of the 1903 Treaty with Panama upon tolls charged for the use of the Panama Canal?

The requirement in Rule I of Article III of the Hay-Pauncefote Treaty, incorporated by reference into the Hay-Bunau-Varilla Treaty, that tolls be "just and equitable" is so vague as to offer no real guidance in the establishment of tolls. In *The Law of International Waterways* 260 (1964), I expressed the view that:

Its sole effect may be to indicate that the question of tolls has been removed from the domestic jurisdiction of the United States. Were an objective examination to be made by an arbitral tribunal of charges for the use of the Canal, the high level of abstraction upon which the standard is cast would make any decision actually one *ex aequo et bono*.

Naturally, a point may come at which the tolls may be set at so high a level as to make them prohibitive. Such rates of toll would be open to challenge on the ground that they are in violation of the right of "free and open" passage. The requirement in the new Neutrality Treaty that "Tolls and other charges for transit and ancillary services shall be just, reasonable, equitable and consistent with the principles of international law" is a substantial improvement from the standpoint of users of the Canal. It will allow the marshalling of a much wider range of evidence of the standards to be used in setting tolls.

It will be recalled that, in so far as the domestic law of the United States is concerned, the attempt of users of the Canal in *Grace Line, Inc. v. Panama Canal Co.*, 356 U.S. 309 (1958), to secure judicial review of the level of tolls was unsuccessful. The provision of the Hay-Pauncefote Treaty about "just and equitable" tolls was one of the provisions of law on which the plaintiff shipping companies had relied. Mr. Justice Douglas, speaking for a unanimous Court, said the problem was "in the penumbra of the law where generally the Executive and the Legislative are supreme" (id. at 317).

3. If the Neutrality Treaty involving guarantees of nondiscriminatory treatment and reasonable tolls is violated, what remedies are available to any state that might seek relief? How would such remedies compare with those available under the present treaties?

The only remedies available in the event of a violation of the Neutrality Treaty are those which exist in the event of any other violation of conventional or customary international law—negotiation, mediation, conciliation, enquiry, arbitration, or adjudication by the International Court of Justice, as may be agreed upon by the parties to the dispute. It would be necessary to consider in each particular instance what obligations of pacific settlement had been undertaken by the parties to the dispute. Panama, it may be noted, has accepted the compulsory jurisdiction of the International Court of Justice, on condition of reciprocity but without reservations, by its declaration of October 25, 1921 ([1975-76] Yearbook of the International Court of Justice 74). A state could bring an action against Panama arising out of an asserted violation of the Neutrality Treaty only if it had itself accepted the compulsory jurisdiction of the Court and had not reserved as to the subject-matter of the cause of action. Panama could, of course, withdraw its acceptance of the jurisdiction of the Court. By reason of the "Connally reservation" of the United States, reserving as to matters within the domestic jurisdiction of the United States as determined by the United States, this country could neither sue nor be sued in the International Court, except by reason of some other instrument, such as a multi-lateral treaty, conferring jurisdiction on the Court.

Until 1999, the United States and Panama will be obliged to settle disputes under Article XIV of the new Panama Canal Treaty, but the article in question does not require resort to any form of compulsory third-party dispute-settlement procedure.

The same situation exists with respect to the Hay-Pauncefote Treaty and the Hay-Bunau-Varilla Treaty: There is no built-in procedure for dispute-settlement in the treaties.

The positions under the Panama Canal treaties stands in contrast to the obligation that Egypt has assumed by its Declaration of April 24, 1957, with respect to the Suez Canal (U.N. Doc. A/3576 (S/3818) (1957)). In paragraph 9(b) of that Declaration, Egypt agreed that:

Differences arising between the parties to the said [Suez Canal] Convention in respect of the interpretation or the applicability of its provisions, if not otherwise resolved, will be referred to the International Court of Justice. The Government of Egypt would take the necessary steps to accept the compulsory jurisdiction of the International Court of Justice in conformity with the provisions of Article 36 of its Statute.



Egypt has, in fact, filed a declaration with the Court in these terms, which of course limit those states benefiting from the declaration to the parties to the Constantinople Convention of 1888 (and thus excludes Israel).

The precedent is an important one. A state willing to accept the jurisdiction of the Court as to Panama Canal matters could now bring an action against Panama but not against the United States. However, Panama is under no legal obligation to maintain its acceptance of the jurisdiction of the Court. It would be highly desirable if both Panama and the United States were, whether jointly or severally, to declare that they accept the compulsory jurisdiction of the Court as to any dispute arising out of the new Panama Canal Treaty or the new Neutrality Treaty. Such a unilateral declaration or declarations would be binding on the two countries and could not be unilaterally revoked, under the decision of the International Court of Justice in the *Nuclear Tests Case*, [1974] I.C.J. Rep. 253. The jurisdiction of the Court being open only to States, it would, of course, be necessary that a foreign state be persuaded to bring an action in the Court in order to vindicate the rights of users. The American owners of ships might benefit from such proceedings if their vessels were registered under the flag of countries that were prepared to resort to the International Court.

A declaration or declarations of this character could be separately drafted and would not require any amendment of the texts of the new treaties. It would offer the best possible guarantee that the two countries are prepared to submit to an objective review of the legality of their conduct under the treaties, including the provisions on tolls.

4. To what extent do the rights of international passage through the Panama Canal depend upon the texts of the treaties as compared with customary international law?

This is not a matter on which there would be any substantial uniformity of opinion amongst international lawyers.

Secretaries of State have in the past expressed the view that third states have no rights under the Treaties of 1901 and 1903. Charles Evans Hughes wrote to President Harding that "other nations \* \* \* not being parties to the [Hay-Pauncefote] treaty have no rights under it" (5 Hackworth, Digest of International Law 221-222 (1943)), and Secretary of State Dulles said in 1956: "And there is no international treating giving other countries any rights at all in the Panama Canal except for a treaty with the United Kingdom which provides that it has the right to have the same tolls for its vessels as for ours". In practical terms, he said, a large number of countries rely on the Suez Canal, but no country in the world fears that its economy will be jeopardized by possible misuse or abuse of United States rights in the Canal (3 Whitman, Digest of International Law 1150 (1964)). These highly nationalistic utterances appear to run counter to the expectations of other countries and to the assumption underlying the new Neutrality Treaty and to the Protocol to the Neutrality Treaty, both of which appear to recognize rights in states other than Panama and the United Kingdom.

The proper legal view, it is submitted, is that expressed by the Permanent Court of International Justice in *The S.S. Wimbledon*. The Court there spoke of the Kiel Canal as "an artificial waterway connecting two open seas [which] has been permanently dedicated to the use of the whole world" (P.C.I.J., ser. A., No. 1 at 28 (1923)). The dedication in this case came through the terms of the Treaty of Versailles, whereby the Canal was thrown open to navigation by the ships of all nations. The corresponding dedication in the case of the Panama Canal was effected through the Hay-Pauncefote Treaty of 1901 and the Hay-Bunau-Varilla Treaty of 1903. It would seem that dedication alone may not be sufficient and should be followed by reliance by the international community in general before third states may with sound legal basis rely on that dedication to free and open use. That reliance has long since taken place in the case of the Panama Canal.

If a canal is itself permanently dedicated to free use by the ships of all nations, that right of free use must have an existence independent of that of the treaty. The treaty defines the details of free passage or a revision of the treaty may alter the terms on which free passage is allowed, but the basic principle of the dedication of the waterway to international use remains and is not altered by the amendment or termination of the governing treaties. A state cannot be allowed to open up an avenue of international communication, to induce other states to establish shipping lanes utilizing the canal and to form trading patterns

in reliance on the canal, and then unilaterally and arbitrarily to shut down the waterway.

International lawyers have sought the rights of third states in other doctrines of international law as well. Some have said that the right of passage constitutes an "international servitude." Others consider that states not parties to the treaty throwing the waterway open to international use are third-party beneficiaries to the treaty and may themselves assert and enforce the rights so conferred. There is also the view that treaties opening up international waterways are "dispositive treaties" creating real rights attached to the territory in question. But the theory of dedication appears to offer the most satisfactory explanation of the rights of third states and of the independence of those rights from what was originally their basis in treaty.

At the present time, the right of free and open passage through the Panama Canal has thus been established in customary international law through the dedication effected by the two Treaties of 1901 and 1903 and exists independently of those treaties. The Treaties of 1901 and 1903 now define the conditions in somewhat differing forms.

5. Since the U.S. and Panama are guarantors of the Panama Canal under the Neutrality Treaty, is it correct to say that ultimate protection of the rights of third party states lies in the creation of mutual international rights and obligations between the third party states and the two countries of Panama and the United States? How do those parties which are not treaty signatories acquire guarantees of passage? In this respect, what will be the effect of the accession to the Neutrality Protocol of the user states?

Any question about the rights of a third state is, of course, obviated by its becoming a party to the Protocol to the Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal. The principal advantage of such a treaty to the United States and Panama is that the parties thereto undertake duties with respect to the Canal, such as respect for its neutrality, compliance with the rules relating to the Canal, and the requirement that no act of hostility be committed within the Canal, as laid out in the Neutrality Treaty. Conditions are thereby turned into promises. The advantages to third states that use the Canal is that they can directly invoke the terms of the Neutrality Treaty without having to establish that they benefit from its terms as third-party beneficiaries.

States that do not become parties to the Protocol may acquire rights under the Neutrality Treaty on two different bases:

The first is that they are third-party beneficiaries under the Neutrality Treaty. Article 36, paragraph 1, of the Vienna Convention on the Law of Treaties of 1969, to which the United States is not a party but which is widely regarded as reflecting contemporary customary international law, provides:

A right arises for a third State from a provision of a treaty if the parties to the treaty intend the provision to accord that right either to the third State, or to a group of States to which it belongs, or to all States, and the third State assents thereto. Its assent shall be presumed so long as the contrary is not indicated, unless the treaty otherwise provides.

Conditions on the exercise of the right are referred to in paragraph 2:

A State exercising a right in accordance with paragraph 1 shall comply with the conditions for its exercise provided for in the treaty or established in conformity with the treaty.

The statement of the Neutrality Treaty that Panama declares the Canal secure and open "to peaceful transit by the vessels of all nations" appears intended to confer a right on "all nations," not simply on the parties to the Protocol to the Neutrality Treaty. The very existence of the two instruments underlines the fact that rights were to arise from the Neutrality Treaty itself.

The second possible basis for the rights of third states is the fact that a unilateral declaration by a state may give rise to rights to be enjoyed by the states to which the declaration is addressed. In the *French Nuclear Tests* case, [1974] I.C.J. Rep. 253, 267, the International Court of Justice stated:

When it is the intention of the State making the declaration that it should be bound according to its terms, that intention confers on the declaration the character of a legal undertaking, the State being thenceforth legally required to follow a course of conduct consistent with the declaration. An undertaking of this kind, if given publicly, and with an intent to be bound, even though not made within the context of international negotiations, is binding. In these circumstances, nothing in the nature of a *quid pro quo* nor any subsequent acceptance of the declaration, not even any reply or reaction from other States, is



required for the declaration to take effect, since such a requirement would be inconsistent with the strictly unilateral nature of the juridical act by which the pronouncement of the State was made.

Although the obligations of Panama are assumed in a bilateral treaty with the United States, Article II of the Neutrality Treaty is in form a unilateral declaration by Panama ("The Republic of Panama declares the neutrality of the Canal \* \* \*"). That declaration, without more, creates rights in other states, since the declaration seems to have been made with the intention that it should be binding.

It is thus not strictly correct to say that "ultimate protection of the rights of the third party states lies in the creation of mutual international rights and obligations between the third party states and the two countries of Panama and the United States." Third states simplify their legal case and convert conditions into promises by becoming parties to the Protocol, but they enjoy those rights quite independently of their becoming parties to that instrument.

6. Article I of the proposed Neutrality Treaty states in part that "The Republic of Panama declares that the Canal, as an international transit waterway, shall be permanently neutral in accordance with the regime established in this Treaty." Customarily, what has the concept of a 'neutral' canal meant, and how do you believe that customary neutrality is affected by the regime established in the treaty? In your view, what user guarantees have become customary aspects of international law?

The terms "neutrality" and "neutralization" have always been used in a somewhat Pickwickian sense when applied to interoceanic canals, such as the Panama Canal. In general, the neutralization of territory would mean that the territorial sovereign would be precluded from taking any military measures, such as the building of defenses, there and that all states recognizing the status would be obliged to refrain from engaging in military activities there. In the Hay-Pauncefote Treaty, on the other hand, "neutralization" rests on the basis of a number of rules, ranging from a requirement of non-discriminatory tolls to the duty of belligerents to refrain from acts of hostility within the Canal. It was even suggested by Sir Edward Grey during the tolls controversy between the United States and the United Kingdom before the First World War that "neutralization must refer to the system of equal rights" ([1912] *Foreign Relations of the U.S.* 481-489, quoted in N. Padelford, *The Panama Canal in Peace and War* 35 (1943)). The term "neutralization" is thus used synoptically to refer to the whole regime of the Canal. The "neutrality of the Canal" proclaimed in the new Neutrality Treaty is likewise linked to the rules and conditions for use of the canal.

Neither the term "neutralization" or "neutrality" is used in the Convention of Constantinople of 1888, governing the Suez Canal, although the rules of that treaty were the basis for the "neutralization" of the Panama Canal under the Hay-Pauncefote Treaty and for making the Canal "neutrality in perpetuity" under the Hay-Bunau-Varilla Treaty. And no such term appears in the Egyptian Declaration of 1956, which now also regulates the status of the Suez Canal.

Nothing in the Treaty of 1901 or the Treaty of 1903 has stood in the way of defense or fortification of the Panama Canal. It has been closed to the warships and merchant ships of enemies of the United States in both World Wars, and restrictions were placed on neutral shipping. In the same way, the Suez Canal has been closed to enemy shipping and has become both the scene and the object of hostile attacks during the Arab-Israeli conflict. The neutrality of the Panama Canal thus does not preclude the United States—or under the new Treaties, the Republic of Panama—from taking belligerent measures in the Canal and in the area of the Canal when either state is at war.

What the treaties governing both the Suez and Panama Canals do purport to do is to lay down the specific rights and duties of neutrality applicable in the Canals when the territorial sovereign is neutral or not a party to the conflict. The belligerents are not to engage in acts of hostility there: their warships are to be passed through as quickly as possible and are not to take on supplies except if strictly necessary; their warships, as is generally true under the law of neutrality in naval warfare, are to be limited in their stay in ports.

It would probably have been better if the concepts of "neutrality" and "neutralization" had never been invoked in connection with Canals. They tend to confuse more than they do to clarify. What count are the actual rights and duties of the United States, Panama, and third states.

The question of what "user guarantees" have passed into customary international law raises quite different issues. If the dedication of a canal to international use by the ships of all nations is to carry any significance, it must entail that the users have rights:

To use the canal, except when a user is at war with the state controlling the canal and except to the extent that the territorial sovereign may place restrictions on the passage of neutral ships in the interest of its own protection.

To have the canal, within the limits of the means available to the state operating it, maintained in good order and operated efficiently.

To have tolls fixed at a reasonable level.

To have such ancillary services provided as are necessary to passage.

To have local law applied in such a way as not to impair passage.

To have necessary improvements made to permit use of the canal by all ships desiring to transit it, but only within the limits of what is feasible for the operator of the canal.

These rights seem to be logically entailed by the general principle of the Canal's being "free and open," but there would not necessarily be agreement on them by states or by authorities on international law.

7. Although the Panama Canal Treaty has numerous references acknowledging the territorial sovereignty of the Republic of Panama, the Neutrality Treaty contains no such specific acknowledgment. What is the relationship between sovereignty and control of the littoral territory and user guarantees for the Canal? What effect, if any, does the absence of acknowledgment of territorial sovereignty have on Panama's relationship to user guarantees both before and after the year 2000?

The absence of acknowledgment of territorial sovereignty in the Neutrality Treaty has no effect on Panama's relationship to user guarantees before or after the year 2000.

The effect of the new Panama Canal Treaty is to terminate the grant of the United States in perpetuity, made under Article II of the Hay-Bunau-Varilla Treaty, of the "use, occupation and control of a zone \* \* \* for the construction, maintenance, operation, sanitation and protection of said Canal \* \* \*" as well as "all rights, power and authority within the zone \* \* \* which the United States would possess and exercise if it were the sovereign of the territory \* \* \* to the entire exclusion of the exercise by the Republic of Panama of any such sovereign rights, power or authority," pursuant to Article III of the same treaty. The remaining interest of Panama in the Canal and Zone was referred to as "titular" or "residual sovereignty." Once the grant is terminated, Panama will resume the full exercise of its sovereignty. The effect of the coming into force of the new Panama Canal Treaty will be the immediate execution of Article II of the new Treaty, terminating the Treaty of 1903 and related agreements. The sovereignty of the Republic of Panama over the territory will thus not be based upon the new Panama Canal Treaty; rather a limitation on the exercise of the sovereignty will have been terminated by the new Treaty. In the exercise of its sovereignty, Panama will assume the obligations of the new Neutrality Treaty, just as any territorial sovereign may accept treaty obligations with regard to an interoceanic canal under its sovereignty. Germany did so with respect to the Kiel Canal by the terms of the Treaty of Versailles; Egypt did so by its unilateral Declaration of April 24, 1957, as well as by succeeding to the obligations of Turkey under the Convention of Constantinople of 1888.

Territorial sovereignty and user guarantees are two separate and distinct matters. A territorial sovereign of an interoceanic canal may neglect to provide user guarantees, while a state which is not a territorial sovereign may provide user guarantees, as the United States did under the Hay-Pauncefote Treaty and the Hay-Bunau-Varilla Treaty.

8. The United States and the Republic of Panama are signatories of a number of international agreements, including the O.A.S. Charter, the Inter-American Treaty of Reciprocal Assistance, and the U. N. Charter. How do you believe these and other international agreements relate to user guarantees in the proposed Canal treaty package?

First, as to the United Nations Charter: The clearest case is one in which the Security Council were to decide to take measures under Chapter VII of the Charter as the result of a determination under Article 39 that there is a "threat to the peace, breach of the peace, or act of aggression." Under Article 41 of the Charter, the measure falling short of the use of force which may be employed



by the Security Council are "complete or partial interruption of economic relations" and of "sea \* \* \* means of communication." Thus the Security Council could order United States (until the year 2000) and Panama to deny passage to the shipping of a particular country or group of countries. It is also open to the United Nations to "take such action by air, sea, or land forces as may be necessary to maintain or restore international peace and security," under Article 42. In either event, obligations under the Charter would, under Articles 103 of that instrument, prevail over the duties of the United States or of Panama to maintain the Canal "secure and open" and over the permanent neutrality of the Canal. Article 103 of the Charter provides:

In the event of a conflict between the obligations of the Members of the United Nations under the present Charter and their obligations under any other international agreement, their obligations under the present Charter shall prevail.

Thus, if the Security Council were to order the Canal to be closed to the ships of a particular state, Panama could not invoke its treaty obligations to allow free passage. The Charter is higher law.

The situation is less clear with respect to the effect of recommendations adopted by the General Assembly under Chapter IV of the Charter or by the Security Council under Chapter VI of the Charter. The United States or Panama would not be obliged to carry out a recommendation, but could either country invoke a recommendation as the basis for closing the Canal pursuant to that recommendation? It would seem that, according to a strict construction of the law, they could not. Their freedom of action would be limited by their treaty obligations, and the recommendation would not be an "obligation" under the Charter which would prevail over an inconsistent treaty under the quoted Article 103. But one cannot exclude altogether the possibility that the sovereign of an interoceanic canal, such as Panama, Egypt, or the Federal Republic of Germany, might invoke a recommendation of the Security Council or the General Assembly as the basis for excluding ships of a state or states or taking other measures to restrict their passage.

The legal situation under the Inter-American System calls for an examination of the Charter of the Organization of American States and the Inter-American Treaty of Reciprocal Assistance of 1947. Under Article 23 of the O.A.S. Charter,

If the inviolability or the integrity of the territory or the sovereignty or political independence of any American State should be affected by an armed attack or by an act of aggression that is not an armed attack, or by an extracontinental conflict, or by a conflict between two or more American States, or by any other fact or situation that might endanger the peace of America, the American States, in furtherance of the principles of continental solidarity or collective self-defense, shall apply the measures and procedures established in the special treaties on the subject.

The special treaty is the Inter-American Treaty of Reciprocal Assistance (the Rio Treaty), under which the Ministers of Foreign Affairs, convened as an "Organ of Consultation," may decide on the measures to be taken. Article 8 provides in part that,

For the purposes of this Treaty, the measures on which the Organ of Consultation may agree will comprise one or more of the following: \* \* \* partial or complete interruption of economic relations or of \* \* \* sea \* \* \* communications. \* \* \*

Measures falling short of the use of armed force are binding upon the parties to the treaty under Article 20.

Panama or the United States might thus be called upon by the Organ of Consultation to shut the Canal to certain foreign vessels or to place restrictions on their passage. In that event, either country would be faced with a conflict between its duties under the Panama Canal Treaty and Neutrality Treaty, on the one hand, and those under the O.A.S. Charter and the Rio Treaty, on the other. An American Republic party to the O.A.S. Charter and the Rio Pact could not complain of the closure of the Canal, because it would have consented to such an action by accepting the obligations of the two Inter-American treaties.

By contrast, a state not a party to these Inter-American Treaties would not be bound by their provisions, which would be *res inter alios acta*, and could properly insist upon the performance of the obligations of Panama or of the United States under the new Panama Canal Treaty and the Neutrality Treaty.

The possibility that there might be a conflict between the Charter or the Inter-American Treaties and the existing instruments regarding the Canal has existed for some time and has not become an actuality over the past thirty years.

It is obviously impossible to envisage at this juncture the possible inconsistencies that might exist between either the new Panama Canal Treaty or the Neutrality Treaty and other treaties. In general the law would be that a treaty between either the United States or Panama and a third state would either grant rights supplemental to those contained in the new Treaties or would waive rights under the Treaties.

9. Is there anything contained in the agreements cited in paragraph 8 above which could, in any way, pose an obstacle in the implementation of Article XIII of the proposed Treaty in which the U.S. meets its new financial obligations to Panama through increased payment by third parties, some of whom are signatories of these agreements?

If the Canal were to be closed under a Security Council resolution, Panama might contend that the United States would be obliged to continue to pay the fixed annuity of \$10,000,000 provided for under paragraph 4(b) of Article XIII of the new Panama Canal Treaty. The United States would presumably plead a fundamental changes of circumstances (*rebus sic stantibus*) as relieving it of the obligation to pay. If, as the result of the closure, the operating revenues were to fall below \$10,000,000, there would *pro tanto* be no operating revenues from which to make the payment. If the closure of the Canal were such that the operating revenues exceeded \$10,000,000, there would be funds available to pay the fixed annuity, but the United States would still be in a position to claim that it was an implied condition of the duty to make the payment that there should be normal Canal revenues. It might, for example, propose that the payment should be reduced to an amount proportionate to the proportion of the year during which the Canal was closed.

The contingency of the closing of the Canal under a Security Council resolution is an unlikely one, and it is improbable that a problem about the payment would arise prior to the year 2000.

10. Experts say that users of international canals are primarily interested in the Canal's freedom of access, facility of passage, and reasonableness of transit charges consistent with proper Canal operation and maintenance. Given these user interests, do the treaties provide sufficiently for them, and what U.S. legislation should be enacted to facilitate user guarantees?

It is easy after the conclusion of a very complex, lengthy, and difficult negotiation to suggest in the abstract how the bargain could have been improved. It might, for example, have been preferable for both Panama and the United States to have provided user guarantees in an instrument in which they would jointly and severally have assumed duties to the entire international community. A more precise formula on the computation of tolls would have been to the advantage of users of the Canal, among which will be the United States, when it ceases to be the operator of the Canal in the year 2000 and reverts to the position of simply another user. But in general the safeguards provided by the Treaties appear to be adequate.

As mentioned in connection with Question 3, it would have been desirable—and it remains desirable—to have a firm undertaking that disputes about the interpretation or application of the Treaties would be taken to the International Court of Justice or some other method of compulsory dispute-settlement. If the United States has considered compulsory dispute-settlement to be essential in the new treaties being negotiated by the Third Law of the Sea Conference, it seems strange that it was satisfied with less as to passage between the seas through an artificial waterway. If an impediment is raised to passage through a strait, the aggrieved state may, as the Law of the Sea Treaty is now drafted, have resort to compulsory dispute-settlement, whereas an impediment to passage through an artificial strait is subject to no such safeguard.

So far as legislation is concerned, new law will presumably be required to give effect to the right of the United States, until 2000, to "Establish, modify, collect and retain tolls for the use of the Panama Canal, and other charges, and establish and modify methods of their assessment," as provided for in subparagraph 2(d) of Article III of the new Panama Canal Treaty. It would be helpful if the users could be accorded a hearing in the determination of the level of tolls, the method of assessment, and the modes of payment.

This would also be an appropriate time to repeal such laws as Section 11 of the Act of August 24, 1912, 37 Stat. 557, 15 U.S.C. § 31, providing for the closure of the Panama Canal to ships owned or controlled by a person who does business in violation of the anti-trust laws. As applied to certain foreign flag vessels, that provision of law seems to be inconsistent with the obligations to allow secure and open passage, assumed by the United States under the terms of the Neutrality Treaty.



Mr. METCALFE. Thank you, Mr. Baxter.  
Now we will hear a brief statement from Mr. Maechling.

### STATEMENT OF CHARLES MAECHLING, JR., ATTORNEY

Mr. MAECHLING. Mr. Chairman, I intend to be equally brief. I am pleased to be here to testify. My testimony is my own and does not represent the views of either the law firm I am associated with or its clients. I would also like to say that I am not opposed to the treaties as such and indeed, believe that a revision of our 1903 arrangement with Panama is long overdue.

Certain aspects of the treaties, however, trouble me and I will summarize these as succinctly as possible. Let me add that I approach this in a slightly different way than Professor Baxter, since my professional connections are mainly with the maritime community and I think are more in terms of the actual effects on maritime shipping and international trade than perhaps the full ramifications of international law.

First, I have been, from the beginning, a little disturbed by the approach of the negotiators and treaty proponents in their advocacy of the treaties, because it has been presented almost exclusively as a Latin American political issue, thus diverting attention from the actual terms of the treaties themselves. In fact, the treaties in some way—or the canal, rather—in some way has been treated as more of a disposable symbol like the Crown of Hungary than as a complex engineering system and vital artery of world commerce.

To me, there is some troublesome features about the free access and nondiscrimination provisions. On the surface the language, I think will demonstrate that the proposed treaties are somewhat better than the current arrangements by way of specific safeguards; but the most important problem is that the obligations that are undertaken by Panama under the Neutrality Treaty run only to the United States and not to the world community.

Under present arrangements, the United States through Britain is bound by the Hay-Pauncefote Treaty to keep the canal open on a non-discriminatory basis to the ships of all flags. In 1957 Egypt gave even more specific guarantees to the signatories of the Suez Canal Treaty of 1888.

Now, under the proposed treaties, which are bilateral, Panama will have no such separate obligation to the world community. I firmly believe that in this regard the much advertised protocol is of cosmetic value only: It permits other nations to recognize and endorse the canal's neutral status, but neither guarantees that status nor requires the far more important reverse obligation on the part of Panama.

Second, during the negotiations insufficient attention, I believe, was paid to the Panamanian position on law-of-the-sea questions. Panama has declared a territorial sea of 200 miles on both coasts, effective 1967, and the same breadth applies to its fishing and economic zones. Now, within this area, on both the Pacific and Caribbean sides, the Panamanian navigation antipollution, innocent passage, and other requirements would, on the effective date of the treaties, apply in full rigor. So would the rights of Panama as a port and coastal state, since the Canal Zone territorial strip extending seaward for 3 miles would no longer exist and the Canal Zone ports will have become Panamanian.

The Neutrality Treaty is lamentably vague as to whether the guaranteed right of access for canal users will modify the right that Panama has under the Territorial Sea Convention of 1958, and the hearings have done little to clarify this point.

The transfer to Panama of plenary jurisdiction over the Canal Zone and over the 3-mile strip of U.S. territorial waters 20 years before effective transfer of the installation itself is, I think, a mistake. Except during the 30-month transition period, it will have the effect of placing the former zone under the vagaries of Panama jurisdiction and police powers, while leaving the United States with effective responsibility for efficient operation and maintenance of the canal. In my opinion, it would have been wiser to make transfer of general jurisdiction coextensive with a final transfer of the canal.

With respect to the tolls question, I think there are three basic issues. First is the principle of the new arrangement. Second, the economic effects which have already been discussed; and third, safeguards for world maritime community.

With respect to the principle it is my understanding that congressional policy for 30 years is to recognize that the annuity to Panama is properly a charge against the foreign policy of the United States. Now, the tolls at the present moment contribute only 30 percent of the \$2.3 million annuity to Panama. What the new treaties propose is that we cede the canal to Panama and then pay Panama to take it, but with other peoples' money.

World commerce is to be shouldered with the burden of what are in some respects really American political subsidies or reparations, depending on the point of view.

The tolls have already been discussed and I will defer to the economic experts on that. However, I do believe that if this complex engineering and financial system is ever treated as a purely profit venture to be milked by the next proprietor for every dollar it can produce, maintenance and operating efficiency will run downhill and the system will deteriorate.

The nondiscriminatory safeguards seem to me in most respects satisfactory, but I think too little attention has been focused on the actual language. If I read articles II and III of the Neutrality Treaty together, they require nondiscrimination as to payment only, not the toll structure. After the year 2000 or indeed before—depending on the views of the Commission, there would be nothing to prevent the rate structure from being slanted in favor of particular categories of cargo or nationalities of exporters or flags of the vessels so long as, obviously, the collection of the tolls—the payment—was done in an equitable and nondiscriminatory way. In fact, this is precisely what Panama intends to do, as confirmed to me by a high Panamanian source.

I am now ready to answer the questions of the committee, Mr. Chairman.

Mr. METCALFE. Thank you, Mr. Maechling. You have a written critique, do you not?

Mr. MAECHLING. Yes, I do.

Mr. METCALFE. I ask at this time for unanimous consent that the entire critique be made a part of the record.

Hearing no objection, so ordered.

[The following was accepted for the record:]



## STATEMENT OF CHARLES MAECHLING, JR.

Mr. Chairman, I am pleased to be here to testify on the proposed Panama Canal Treaties. By way of introducing myself, let me state that I am a former State Department official and law professor, currently of counsel to the law firm of Kirlin, Campbell & Keating, of New York City and Washington, D.C. My testimony is my own, and does not represent the views of either Kirlin, Campbell & Keating or its clients.

I have already put into the record a Critique of the Panama Canal Treaties viewed from the standpoint of a private international lawyer. Neither in the Critique nor here do I take a position opposed to the Treaties as such, and indeed I believe that a revision of our 1903 arrangement with Panama is long overdue. But certain aspects of the Treaties trouble me. Before addressing the specific questions raised by the Committee, I will summarize these as succinctly as possible.

First, as to the approach of the negotiators and treaty proponents. By presenting the complex question of treaty revision almost exclusively as a Latin American political issue public attention has been diverted from the actual terms of the Treaties themselves. The Canal itself has been treated more as a disposable symbol—like the crown of Hungary—than as a complex engineering system and vital artery of logistic support and world commerce that we trifle with at our peril. In negotiating these Treaties the other maritime powers and commercial users were accorded only the most perfunctory consultation.

There are troublesome features about the free access and non-discrimination provisions of the Neutrality Treaty. First and most important is the fact that the obligations undertaken by Panama run only to the United States and not to the world community. Under the present arrangement the United States, through Britain, is bound by the Hay-Pauncefote Treaty to the world community to keep the Canal open on a non-discriminatory basis to the ships of all nations. In 1957 Egypt gave even more specific guarantees to the signatories of the Suez Canal Treaty of 1888. Under the proposed Treaties Panama will have no such separate obligation to the world community. In this regard the much-advertised Protocol is of cosmetic value only: it permits other nations to recognize and endorse the Canal's neutral status, but neither guarantees that status nor requires the far more important reverse obligation on the part of Panama.

During the negotiations, insufficient attention was paid to the Panamanian position on law-of-the-sea questions. For example, Panama has a declared territorial sea of 200 miles on both coasts; the same breadth applies to its fishing and economic zones. Within this area on both the Caribbean and Pacific sides Panamanian navigational, anti-pollution, "innocent passage", and other requirements would, on the effective date of the Treaties, apply in full rigor. So would the rights of Panama as a port and coastal state, since the Canal Zone territorial strip extending seaward for three miles would no longer exist and the Canal Zone ports will have become Panamanian. The Neutrality Treaty is lamentably vague as to whether the guaranteed right of access for Canal users will modify the rights that Panama has under the Territorial Sea Convention of 1958, and the hearings have done little to clarify this point. I will discuss this in more detail later.

The transfer to Panama of plenary jurisdiction over the Canal Zone and over the 3-mile strip of U.S. territorial waters twenty years before effective transfer of the installation itself is, I think a mistake. Except during the 30-month transition period, it will have the effect of placing the former Zone under the vagaries of Panamanian general jurisdiction and police protection while leaving the United States with effective responsibility for the efficient operation and maintenance of the Canal. It would, in my opinion have been wiser to make transfer of general jurisdiction coextensive with a final transfer of the Canal.

With respect to the tolls question there are three basic issues: First, the principle of the new arrangement; second, its economic effects; and third, safeguards for the world maritime community.

With respect to the principles, congressional policy for 30 years has recognized that the annuity to Panama is properly a charge against the foreign policy of the United States. Tolls now contribute only 30 percent of the \$2.3 million annuity to Panama. What the new Treaties propose is that we cede the Canal to Panama and pay Panama to take it—but with other peoples' money. World commerce is being shouldered with the burden of what are really American political subsidies or reparations, depending on the point of view. This is unfair.

Second, as to the tolls themselves. The Canal cannot tolerate an estimated \$60-100 billion in payments to Panama without a drastic increase in tolls. The two most recent increases in tolls totaled nearly 40 percent, and at the time of the last 19.7 percent increase in 1976 it was estimated that the Canal could not tolerate more than another 25 percent increase without losing traffic to alternative routes. Once this complex engineering system is treated as a purely profit venture, to be milked for every dollar it can produce, maintenance and operating efficiency will run downhill and the whole system will deteriorate.

Of equal importance are the non-discriminatory safeguards. While in most respects satisfactory, too little attention has been focussed on the actual language of Articles II and III of the Neutrality Treaty, which together require non-discrimination as to payment only—not toll structure. After the year 2000 (or indeed before, depending on the views of the Commission) there will be nothing to prevent the imposition of a rate structure slanted in favor of particular categories of cargo, or nationalities of the exporter, or flag of the vessel—and in fact this is precisely what Panama intends to do, as confirmed to me by a high Panamanian source.

Let me turn to the specific questions raised by the Committee :

#### RESPONSES TO QUESTIONS

*Question 1.* How do the international legal guarantees now provided users of the Canal compare with the guarantees provided in the proposed Treaties? For example, what becomes of the six rules under the Hay-Pauncefote Treaty? Article III(c) of the Neutrality Treaty indicates that "tolls and other charges for transits and ancillary services, services shall be just, reasonable, equitable, and consistent with the principles of international law." What does "reasonable" mean in this context? What effect do these constraints have if the new treaties enter into force?

Answer. Under the present legal regime, guarantees for users stem from Article XVIII of the Hay-Bunau-Varilla Treaty of 1903 :

"The Canal, when constructed, and the entrances thereto shall be neutral in perpetuity, and shall be opened upon the terms provided for by Section I of Article III of, and in conformity with all the stipulations of, the treaty entered into by the Governments of the United States and Great Britain on November 18, 1901".

The stipulations referred to are primarily the six rules of Article III of the Hay-Pauncefote Treaty of 1901. Subparagraph 1 applies to peacetime maritime users:

"The United States adopts, as the basis of the neutralization of such ship canal, the following Rules, substantially as embodied in the Convention of Constantinople, signed the 28th [sic] October, 1888, for the free navigation of the Suez Canal, that is to say :

"1. The Canal shall be free and open to the vessels of commerce and of war of all nations observing these rules, on terms of entire equality so that there shall be no discrimination against any such nation, or its citizens or subjects, in respect of the conditions or charges of traffic, or otherwise. Such conditions and charges of traffic shall be just and equitable \* \* \*"

If the foregoing provision is compared with Articles II and III of the proposed Neutrality Treaty the advantage for users at first blush seems to lie with the latter. Clearly the stipulations of neutrality on the part of Panama are stronger in the Neutrality Treaty than in the Hay-Pauncefote Treaty. Tolls (Article III-c) must be "reasonable" and "consistent with the principles of international law" in addition to being just and equitable. "Reasonable" is helpful, though there are almost no general principles of international law applicable to Canal tolls. The non-discriminatory provision of the Neutrality Treaty is also more explicit than the Hay-Pauncefote Treaty.

But the advantage of more explicit language in the Neutrality Treaty is largely vitiated by the fact that the obligations run to the United States alone, not to the world community through a third country (Britain) as in the case of the Hay-Pauncefote Treaty. Moreover the non-discriminatory requirement applicable to tolls (Article II-a and III-c) refers to payment only. There would be nothing to prevent Panama from imposing a totally discriminatory rate structure—based for example on flag of vessel or class of cargo—so long as such rates were levied on all traffic equally; and this is precisely what Panama intends to do as confirmed to me by a high Panamanian source!



*Question 2.* What is the effect of the provisions of the Hay-Pauncefote Treaty and of the 1903 Treaty with Panama upon tolls charged for the use of the Panama Canal?

Answer. The actual rate structure of the Canal springs rather from implementing statute than from any specific Treaty provision. The Panama Canal has been run with outstanding efficiency, at minimal cost to the world community and no profit to the United States—an exemplary illustration of the requirement that “charges of traffic shall be just and equitable”. All the protective language that can be devised will not protect the user from a canal owner determined to distort them to his own purposes.

It is the statesmanlike policy of the United States in limiting itself to a “cost” operation, rather than specific treaty language, that has hitherto resulted in reasonable tolls.

*Question 3.* If the Neutrality Treaty involving guarantees of nondiscriminatory treatment and reasonable tolls is violated, what remedies are available to any state that might seek relief? How would such remedies compare with those available under the present treaties?

Answer. The question of remedies against interference with transit is largely theoretical where the shipping community is concerned. Vessels are at the mercy of the canal proprietor and can only obtain redress through the flag state. Unless the flag state could procure rapid action through force or diplomacy, its only recourse would be to proceed at glacial pace through the World Court.

The standing of third party states is in any case equally theoretical. The legal regime of an international canal rests on effective territorial sovereignty qualified by treaty obligations. Some authorities consider that particular treaty regimes are “constitutive or semi-legislative” and therefore creative of third-party rights. Others consider that the establishment of an international canal regime by treaty coupled with reliance by maritime users, creates a sort of “dedication” to the world community. The latter view has judicial support in the 1923 opinion of the earlier World Court in the case of the *Wimbledon* (P.C.I.J. Series A, No. 1: World Court Reports I, 163) which assimilated the Kiel Canal to a natural strait on the basis of constructive dedication.

Whether third party rights exist on even a theoretical basis in the case of the Panama Canal depends to some extent on its international status. Until recently the United States maintained that the Suez Canal was international but the Panama Canal was not. The language and negotiating history of the new treaties does not indicate that there will be any change when effective territorial sovereignty is transferred to Panama upon ratification, and full control after 2000 A.D. This points up a principal weakness of the proposed treaties—to be discussed in greater detail under Question 5—that they will be bi-lateral only, with no separate obligation running to the world community as in the case of the Suez Canal.

A separate question is the rights of third party states on the access routes through adjacent waters. Under the proposed Neutrality Treaty, a broad definition of Canal to include access routes through the Panamanian territorial sea provides precisely the same guarantees of non-discriminatory and uninterrupted transit as for the Canal itself. To this extent the Neutrality Treaty is an improvement, since no such guarantee has protected other states since Panama established a 200-mile territorial sea in 1967.

Nevertheless, the failure of the negotiators to establish the relationship of the Territorial Sea Convention of 1958 to the access provisions of the Neutrality Treaty leaves some uncertainty as to which controls and in what circumstances. Third states which are signatories with Panama of the Territorial Sea Convention would however have much more standing under this umbrella than under the bi-lateral Neutrality Treaty.

*Question 4.* To what extent do the rights of international passage through the Panama Canal depend upon the texts of the treaties as compared with customary international law?

Answer. The three artificial international waterways—the Suez, Panama and Kiel Canals—are each regulated by separate treaty to such an extent that, in my opinion, they pre-empt any international law that might otherwise apply. Some authorities maintain that collectively these treaties establish an international *corpus* of artificial waterway law, but on any specific question the particular treaty regime would almost certainly control.

A large body of international law, especially including the High Seas and Territorial Waters conventions of 1958, would apply to the ocean approaches of these waterways and the rights of littoral states.

*Question 5.* Since the U.S. and Panama are guarantors of the Panama Canal under the Neutrality Treaty, is it correct to say that ultimate protection of the rights of third party states lies in the creation of mutual international rights and obligations between the third party states and the two countries of Panama and the United States? How do those parties which are not treaty signatories acquire guarantees of passage? In this respect, what will be the effect of the accession to the Neutrality Protocol of the user states?

There is a significant difference between the present treaties and those under consideration. Under the present arrangement the Canal proprietor, the United States, has through the Hay-Pauncefote Treaty with Great Britain made a pledge to third party states of the world community that the Canal will at all times be open to the ships of all nations on a non-discriminatory basis with just and equitable charges of traffic. Under the Neutrality Treaty Panama has no such obligation. To require third party maritime states to each negotiate a separate agreement with Panama for guaranteed transit after the year 2000 is certainly a clumsy and unsatisfactory solution.

Under the proposed Treaties, parties that are not, signatories acquire no guarantees of passage. The Protocol—surrounded by so much fanfare—is cosmetic and adds little in this regard. Its signatories recognize and endorse the neutrality of the Canal but the vital reverse obligation from Panama to the world community is conspicuously missing.

Compare the weakness of the proposed treaties with the Suez Canal guarantees. On April 24, 1957, after nationalization of the Suez Canal and the 1956 crisis, Egypt filed a declaration with the United Nations in effect adhering to the Suez Canal Convention of 1888 with specific undertakings as to freedom of navigation, system of tolls and percentage of permissible increases, operating regulations, claims, etc. (See Attachment)

*Question 6.* Article I of the proposed Neutrality Treaty states in part that "The Republic of Panama declares that the Canal, as an international transit waterway, shall be permanently neutral in accordance with the regime established in this Treaty." Customarily, what has the concept of a "neutral" canal meant, and how do you believe that customary neutrality is affected by the regime established in the treaty? In your view, what user guarantees have become customary aspects of international law?

Answer. The 1903 Hay-Bunau-Varilla Treaty, Article XVII provides that: "The Canal, when constructed, and the entrances thereto shall be neutral in perpetuity . . ." and opened in accordance with the terms of the Hay-Pauncefote Treaty, which has neutralization as one of its stated principles (Article IV). The Suez Canal Convention does not use the term, but Article IV contains specific provisions barring an act of war within the Suez Canal or within three miles of its ports. The term "neutral" does not really apply to the Kiel Canal which was built as an internal waterway.

Of the two principal international canals, the Panama Canal, although formally the more "neutral", has been totally subjected to U.S. military jurisdiction and control during periods of U.S. wartime belligerency; so has the Kiel Canal by Germany. Except during the recent Middle East crisis, the Suez Canal has managed to remain open to belligerents of both sides. No international canal has so far remained "neutral" when the littoral state itself was a belligerent.

Even before its own belligerency in 1917 and 1941, the United States established tight controls over access to and transit through the Panama Canal by belligerent vessels. It also abided closely to the Hague Convention No. XIII of 1907 with respect rights and obligations of belligerent vessels in neutral waters and neutral ports. Once Panama becomes the littoral state—which will occur on the effective date of the treaties, not in A.D. 2000—all or most of these precedents will apply, unless specifically qualified by the treaties themselves.

In summary, there is really no generalized concept of a "neutral" canal apart from specific cases. Nor are there any "user guarantees" applicable to transit and access that can be derived from general principles of international law, except for the aforementioned Hague Convention and the 1958 Convention on the Territorial Sea. Where specific user guarantees are concerned the Suez Canal offers the best; the existing Panama Canal Treaty the next best; and the proposed Panama Canal Treaties the least satisfactory.

*Question 7.* Although the Panama Canal Treaty has numerous references acknowledging the territorial sovereignty of the Republic of Panama, the Neutrality Treaty contains no such specific acknowledgement. What is the relationship between sovereignty and control of the littoral territory and user guarantees



for the Canal? What effect, if any, does the absence of acknowledgement of territorial sovereignty have on Panama's relationship to user guarantees both before and after the year 2000?

Answer. As stated above, the whole concept of a "neutral" canal becomes unrealistic when the littoral state becomes a belligerent. In the case of the Panama Canal the littoral state, the United States, is now the effective sovereign; upon the effective date of the proposed treaties Panama will become both littoral state and sovereign. On the other hand, if the new littoral state and sovereign is not belligerent it will presumably be obliged to grant belligerent and even politically unfriendly vessels the same rights of access and transit that the United States has granted in the past—but subject to the same or similar controls as in 1914 and 1939.

As stated above there are no direct "user guarantees" in the new treaties to the same extent as provided for by the Suez Canal Convention and 1957 Egyptian Declaration, or indeed by the existing Panama Canal Treaties.

*Question 8.* The United States and the Republic of Panama are signatories of a number of international agreements, including the O.A.S. Charter, the Inter-American Treaty of Reciprocal Assistance, and the U.N. Charter. How do you believe these and other international agreements relate to user guarantees in the proposed Canal treaty package?

Answer. These agreements each impose obligations on Panama and the United States which might in certain circumstances require them to take action in the interest of "collective security". To this extent they would conflict with the obligations of the two countries as guarantors of the neutrality of the Panama Canal. There is no way of resolving all of the resulting conflicts and inconsistencies, but they do make a separate and independent commitment of access and transit by Panama to user nations all the more important.

*Question 9.* Is there anything contained in the agreements cited in paragraph 8 above which could, in any way, pose an obstacle to the implementation of Article XIII of the proposed Treaty in which the U.S. meets its new financial obligations to Panama through increased payment by third parties, some of whom are signatories of these agreements?

Answer. Chiefly in the sense that an obligation to take action against particular nations might result in an interruption of the commerce of such nations, and therefore of toll-paying traffic through the Canal.

*Question 10.* Experts say that users of international canals are primarily interested in the Canal's freedom of access, facility of passage, and reasonableness of transit charges consistent with proper Canal operation and maintenance. Given these user interests, do the treaties provide sufficiently for them, and what U.S. legislation should be enacted to facilitate user guarantees?

Answer. The two proposed treaties definitely do not provide adequate user guarantees. Either the Protocol should be drastically modified to provide a reciprocal guarantee by Panama to the maritime users, or reservations should be incorporated in the Neutrality Treaty providing that it shall not go into effect until Panama makes an independent commitment to the maritime users similar to that made by Egypt in 1957.

In addition, the Neutrality Treaty—or failing this, either the Protocol or the suggested Declaration—should be amended by providing for uninterrupted operation of the Canal regardless of temporary financial stringencies or economic conditions; for maintenance, logistic support and technological improvements up to a prescribed standard; for rate structures and toll increases according to prescribed criteria; and for a broader degree of immunity from potential Panamanian harassment for vessels transiting the Canal than is now legally possible in the 200-mile Panamanian Territorial Sea.

#### ATTACHMENT

##### TEXT OF THE DECLARATION OF THE SUEZ CANAL

The full text of the Egyptian Declaration on the Suez Canal and its operation was as follows:

##### DECLARATION

In elaboration of the principles set forth in their memorandum dated March 18, 1957, the Government of the Republic of Egypt, in accord with the Constantinople

Convention of 1888 and the Charter of the United Nations, make hereby the following Declaration on the Suez Canal and the arrangements for its operation.

#### 1. *Reaffirmation of Convention*

It remains the unaltered policy and firm purpose of the Government of Egypt to respect the terms and the spirit of the Constantinople Convention of 1888 and the rights and obligations arising therefrom. The Government of Egypt will continue to respect, observe and implement them.

#### 2. *Observance of the Convention and of the Charter of the United Nations*

Will reaffirming their determination to respect the terms and the spirit of the Constantinople Convention of 1888 and to abide by the Charter and the principles and purposes of the United Nations, the Government of Egypt are confident that the other signatories of the said Convention and all others concerned will be guided by the same resolve.

#### 3. *Freedom of navigation, tolls, and development of the Canal*

The Government of Egypt are more particularly determined:

(a) To afford and maintain free and uninterrupted navigation for all nations within the limits of and in accordance with the provisions of the Constantinople Convention of 1888;

(b) That tolls shall continue to be levied in accordance with the last agreement concluded on April 28, 1936, between the Government of Egypt and the Suez Canal Maritime Company, and that any increase in the current rate of tolls within any twelve months, if it takes place, shall be limited to 1 per cent, any increase beyond that level to be the result of negotiations, and, failing agreement, be settled by arbitration according to the procedure set forth in paragraph 7 (b).

(c) That the Canal is maintained and developed in accordance with the progressive requirements of modern navigation and that such maintenance and development shall include the 8th and 9th Programs of the Suez Canal Maritime Company and such improvements to them as are considered necessary.

#### 4. *Operation and management*

The Canal will be operated and managed by the autonomous Suez Canal Authority established by the Government of Egypt on July 26, 1956. The Government of Egypt are looking forward with confidence to continued co-operation with the nations of the world in advancing the usefulness of the Canal. To that end the Government of Egypt would welcome and encourage co-operation between the Suez Canal Authority and representatives of shipping and trade.

#### 5. *Financial arrangements*

(a) Tolls shall be payable in advance to the account of the Suez Canal Authority at any bank as may be authorized by it. In pursuance of this, the Suez Canal Authority has authorized the National Bank of Egypt and is negotiating with the Bank of International Settlement to accept on its behalf payment of the Canal tolls.

(b) The Suez Canal Authority shall pay to the Government of Egypt 5 per cent of all the gross receipts as royalty.

(c) The Suez Canal Authority will establish a Suez Canal Capital and Development Fund into which shall be paid 25 per cent of all gross receipts. This Fund will assure that there shall be available to the Suez Canal Authority adequate resources to meet the needs of development and capital expenditure for the fulfillment of the responsibilities they have assumed and are fully determined to discharge.

#### 6. *Canal Code*

The regulations governing the Canal, including the details of its operation, are embodied in the Canal Code which is the law of the Canal. Due notice will be given of any alteration in the Code, and any such alteration, if it affects the principles and commitments in this Declaration and is challenged or complained against for that reason, shall be dealt with in accordance with the procedure set forth in paragraph 7 (b).

#### 7. *Discrimination and complaints relating to the Canal Code*

(a) In pursuance of the principles laid down in the Constantinople Convention of 1888, the Suez Canal Authority, by the terms of its Charter, can in no case grant any vessel, company or other party any advantage or favour not accorded to other vessels, companies or parties on the same conditions.



(b) Complaints of discrimination or violation of the Canal Code shall be sought to be resolved by the complaining party by reference to the Suez Canal Authority. In the event that such a reference does not resolve the complaint, the matter may be referred, at the option of the complaining party or the Authority, to an arbitration tribunal composed of one nominee of the complaining party, one of the Authority and a third to be chosen by both. In case of disagreement, such third member will be chosen by the President of the International Court of Justice upon the application of either party.

(c) The decisions of the arbitration tribunal shall be made by a majority of its members. The decisions shall be binding upon the parties when they are rendered and they must be carried out in good faith.

(d) The Government of Egypt will study further appropriate arrangements that could be made for fact-finding consultation and arbitration on complaints relating to the Canal Code.

#### *8. Compensation and claims*

The question of compensation and claims in connection with the nationalization of the Suez Canal Maritime Company shall, unless agreed between the parties concerned, be referred to arbitration in accordance with the established international practice.

#### *9. Disputes, disagreements or differences arising out of the Convention and this Declaration*

(a) Disputes or disagreements arising in respect of the Constantinople Convention of 1888 or this Declaration shall be settled in accordance with the Charter of the United Nations.

(b) Differences arising between the parties to the said Convention in respect of the interpretation or the applicability of its provisions, if not otherwise resolved, will be referred to the International Court of Justice. The Government of Egypt would take the necessary steps in order to accept the compulsory jurisdiction of the International Court of Justice in conformity with the provisions of Article 36 of its Statute.

#### *10. Status of this Declaration*

The Government of Egypt makes this Declaration, which re-affirms and is in full accord with the terms and spirit of the Constantinople Convention of 1888, as an expression of their desire and determination to enable the Suez Canal to be an efficient and adequate waterway linking the nations of the world and serving the cause of peace and prosperity.

This Declaration, with the obligations therein, constitutes an international instrument and will be deposited and registered with the Secretariat of the United Nations.

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### THE PANAMA CANAL TREATIES

#### CRITIQUE

(The following covers provisions applicable to private interests only—provisions entirely relating to government personnel and property and to the proposed sea level canal are not covered.)

#### *Scope and duration of the new treaties*

There are two treaties under the proposed arrangements: (1) The Panama Canal Treaty, and (2) The Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal, with separate Protocol attached (hereinafter called Neutrality Treaty). Both treaties are bilateral only, though the Protocol of the Neutrality Treaty is open to "accession" by other nations.

The Panama Canal Treaty abrogates all prior treaties between the United States and Panama relating to the Canal, and establishes a new transitional regime and provision for turnover of the former Canal Zone and Canal to Panama. This treaty has a fixed duration of 23 years and expires on December 31, 1999.

The Neutrality Treaty with Protocol are designed to insure the permanent neutrality and accessibility of the Canal to international shipping and are intended to be of indefinite duration (at least no expiration date is indicated).

#### *Sovereignty and jurisdiction*

By the preamble of the Canal Treaty, the United States "acknowledges the Republic of Panama's sovereignty over its territory," and in Articles 1-2 and

III-1 Panama is referred to as "territorial sovereign". Whether this language merely constitutes recognition of a prior condition or is a declaration that henceforth Panama will be recognized as full territorial sovereign is at least ambiguous, though the practical effect may be the same; at any rate it constitutes a recognition of sovereignty. Article II of the Treaty gives the United States the right to operate and maintain the Canal and its "complementary works, installations and equipment" and to use certain "areas, waters and installations" for the duration of the Treaty.

By Article XI, Panama "shall reassume plenary jurisdiction over the former Canal Zone upon entry into force of this Treaty"; (i.e., 6 months after the date of exchange of instruments of ratification) and becomes responsible (Art. III-6) for providing within the former Zone "services of a general jurisdictional nature" such as postal services, customs, courts, etc. On the same date (by Article III-10) the Panama Canal Company and Canal Zone Government "shall cease to operate within the territory of the Republic of Panama that formerly constituted the Canal Zone". (This also extinguishes U.S. jurisdiction over a 3-mile strip of territorial waters on both the Atlantic and Pacific coasts, which becomes part of Panama's claimed 200-mile territorial sea. Canal Zone ports also become Panamanian.)

Article XI, Section 2, provides for a 30-month transition period during which time "the criminal and civil laws" of the United States apply concurrently with those of Panama in the areas and installations (but not waters) made available to it under Article II; Section 4 grants the United States "police authority" during this period of concurrent jurisdiction. Under Section 5 of Article XI, U.S. courts may continue to function in the former Canal Zone during the transition period, but subject to the limitations of Section 6 whereby they shall have no jurisdiction over new cases "of a private civil nature," but retain full jurisdiction only for the purpose of disposing of civil cases, including admiralty cases, "already instituted and pending" before the effective date of the treaty. Under Section 7, U.S. laws, regulations and administrative authority continue in effect for purposes of judicial jurisdiction only during the 30-month transition period; and by Article IX-2 the legal status of private business entities appears to be likewise protected during the transition period. After the transition period, concurrent jurisdiction (to the extent provided for) ceases, and the law of Panama applies throughout the former Zonal area.

Section 8 of Article IX provides for protection of U.S. government rights under the Treaty from any action or enforcement by Panama of any law, regulation or international agreement which might affect such rights. There appears to be no similar provision, however, protecting the rights of private parties, U.S. and foreign, from the effect of Panamanian law and regulation enacted after the effective date of the Treaty, unless specifically covered by Treaty. Section 9 of Article IX does, however, exempt vessels transiting the Canal, and their cargo, passengers and crew from Panamanian fees and taxes, unless they call at a Panamanian port in which case normal charges apply.

In short, after the effective date of the new Treaties, U.S. and foreign citizens, private entities and vessels become wholly subject to Panamanian law and jurisdiction except within areas and installations retained by the United States for operation of the Canal where the U.S. has concurrent jurisdiction for a 30-month period. In the case of pending litigation, admiralty or otherwise, antedating such effective date, the United States likewise has concurrent jurisdiction for a 30-month period. The concurrent jurisdiction applicable to Canal areas and installations during the transition period apparently does not apply to Panamanian waters, except for pending admiralty cases. Note that Panamanian waters consist of a claimed 200-mile territorial sea in which "innocent passage", not "free transit" is the rule.

#### *Non-discriminatory transit and access*

Transit through and access to the Canal will be regulated by provisions in both the Panama Canal Treaty and the Neutrality Treaty.

By Article I-2 of the Panama Canal Treaty the United States has the right for the duration of the treaty "to regulate the transit of ships through the Panama Canal and to manage, operate, maintain, improve and defend the Canal."

By Article III-2(c) of the Panama Canal Treaty the United States is empowered until the year 2000 to make and enforce all rules pertaining to passage of vessels through the Canal, and "other rules with respect to navigation and maritime matters"; the Republic of Panama is required to "lend its cooperation, when necessary" in enforcement.



During this period the United States may also, by subparagraph (d) of Article III-2 "Establish, modify, collect and retain tolls" \* \* \* "and establish and modify methods of their assessment"; but this paragraph must obviously be read in conjunction with Article XIII which provides that annuities to Panama will be wholly derived from such tolls. Other subparagraphs in Article III-2 provide ample authority for the United States to exercise and enforce Treaty rights during the life of the Treaty.

Under Article III-3 the Panama Canal Company, through which U.S. rights and powers were heretofore exercised, is abolished, and a new Panama Canal Commission is established to perform substantially the same functions; by virtue of a U.S. majority on its 9-man Board of Directors, the Commission remains under effective U.S. control for the life of the Treaty. As a practical matter, therefore, the problem of non-discriminatory transit and access only arises after expiration of the Panama Canal Treaty in 2000 A.D.

Upon termination of the Panama Canal Treaty in 2000 A.D. the Republic of Panama, under Article XIII assumes "total responsibility for the management, operation and maintenance of the Panama Canal \* \* \*".

Transit through the Canal by vessels of all categories is covered by the Neutrality Treaty, of indefinite duration, Article II contains a declaration by Panama—to the United States alone—that the Panama Canal shall at all times remain open "to peaceful transit by the vessels of all nations on terms of entire equality, so that there will be no discrimination against any nation, or its citizens or subjects, concerning the conditions or charges of transit, or for any other reason \* \* \*"; payment of tolls and other charges, and compliance with transit regulations, are made subject to this requirement. Article VI gives U.S. and Panamanian warships and auxiliary vessels the right of expeditious transit which the United States interprets as priority (Linowitz at Senate hearings, September 26, 1977) and Panama as meaning only "as fast as possible", except "in case of need and emergency" when they are entitled "to go to the head of the line" (Statement of Understanding of Oct. 17, 1977).

Under Article III of the Neutrality Treaty, both parties obligate themselves—for the indefinite future—to operate the Canal efficiently pursuant to reasonable regulations and to provide ancillary services necessary to transit. However, Section 1-(d) of this article requires private vessels to "establish clearly the financial responsibility and guarantees for payment" for damages resulting from passage through the Canal as "a precondition of transit".

As regards warships and "auxiliary vessels" Article VI of the Neutrality Treaty gives Panama and the United States unconditional rights of transit irrespective of internal operation, propulsion, origin, destination, armament or cargo. By Article III-(e) vessels of other nations have the same unconditional rights, except for cargo—but Article III-(e) also allows these foreign vessels to refuse to disclose their internal operation, origin, armament, destination, or cargo—which seems to nullify the U.S. right to inspect.

By Annex A of the Neutrality Treaty, "Canal" is defined to include Panamanian territorial waters so that non-discriminatory access through these approaches is guaranteed to the same extent as actual transit. Panama's territorial sea is 200 miles, as is its fishing zone and economic zone. Within this area, in both Caribbean and Pacific, Panamanian navigational, anti-pollution and "innocent passage" requirements would therefore apply in full discretionary rigor, but presumably modified by the Neutrality Treaty along access routes.

The obligations of Panama under the Neutrality Treaty extend only to the United States and not, as in the case of Egypt's Declaration of April 24, 1957 with respect to the Suez Canal under the 1888 Convention of Constantinople, to other nations. The Protocol is merely a recognition and an endorsement of the Canal's neutral status. It is not a guarantee of neutral status. Nor does it include a reverse obligation by Panama to the signatories of the Protocol.

#### *Tolls and economic provision*

By Article III-2(d) of the Panama Canal Treaty, effective control over the toll structure of the Canal until 2000 A.D. remains with the United States subject to the new requirement, set forth in Article XIII, that henceforth and for the duration of the Treaty the annual payments to Panama shall be derived from tolls instead of being a charge on the foreign policy of the United States.

Under the new treaties, there will be a drastic change in the principles underlying future annuity payments to Panama. At the present time this payment is fixed at \$2.3 million annually, of which only \$700,000 is derived from tolls. After

the effective date of the treaties payments to Panama will henceforth be derived exclusively from tolls, as specified in Article XIII-4(a) :

(a) An annual payment from toll revenues of 30 cents per Panama Canal ton (to be adjusted periodically for inflation).

(b) A non-deductible fixed sum of \$10 million per annum, and an additional \$10 million per year if Canal traffic and revenues permit.

(c) Service charges of \$10 million, adjusted periodically for inflation and "other factors".

The result of the above formula will mean that after ratification toll-derived payments to Panama will jump from \$700,000 to a minimum of \$60 million and a possible axiom of over \$100 million depending on the rate of tolls and the extent to which North Slope oil transiting the Canal approaches or exceeds 500,000 barrels a day.

Current Canal Zone expenses will be reduced when various facilities and installations are transferred to the Republic of Panama. In addition, the \$319 million investment of the United States would be extinguished, eliminating a \$16 million annual interest payment to the U.S. Treasury. There would nevertheless be no way to load an additional \$60-100 million in payments to Panama on top of fixed expenses without a sharp increase in Canal tolls, estimated by the Panama Canal Company, DOT and Commerce in the recent Senate hearings at from 25-40 percent. In theory a heavy flow of traffic, especially Alaskan oil, would keep the toll increases down, but this assumes the same kind of "cost operation" as before.

Administration projections are that even a 100 percent increase in tolls would only raise the value of an average ton of delivered Canal-transiting cargo (now estimated at \$300) by 0.43 percent. Earlier Panama Canal Company studies indicated that even a 40 percent raise in tolls would start causing diversion of cargo to other routes and transportation modes. In any event, the net effect is to shift the burden of compensatory payments to Panama from the United States to world commerce.

Upon expiration of the Panama Canal Treaty on December 31, 1999 all control over tolls reverts to Panama in accordance with Article XIII-1. Article III(c) of the Neutrality Treaty obligates Panama to establish tolls and other charges for transit and auxiliary charges that are "just, reasonable, equitable and consistent with the principles of international law"; Article II extends its non-discriminatory requirement to the tolls established by Article III(c), but as to payment only, not toll structure; there is no provision to prevent a sliding-scale toll structure for vessels of different nations. Nor is there anything to prevent a toll structure based on different categories of cargo—and in fact, this seems to be the intention of the language (as confirmed to the writer by a high Panamanian source).

### *Defense*

Under the Panama Canal Treaty the United States appears to have extensive rights and responsibility for protection and defense of the Panama Canal until the year 2000—in some respects greater than at present.

By Article I-2, the Republic of Panama unconditionally grants to the United States for the duration of the Treaty the rights necessary to "manage, operate, maintain, improve, protect and defend the Canal." Under Article IV the United States has "primary responsibility to protect and defend the Canal." Other articles give it the right to station, train, and move military forces within Panama, and to retain bases and installations within the former Zone area subject to special "status of forces" agreements. Defense Secretary Brown and the Joint Chief of Staff testified at Senate hearings on September 27, 1977, that this gives the United States use of all Panamanian land, sea and air space in defense of the Canal during the life of the Treaty. Apart from new jurisdictional limitations over application of Panamanian law to U.S. military personnel, there appear to be few practical limitations over U.S. defense rights within the former Canal Zone and indeed the whole Republic of Panama.

After expiration of the Treaty in 1999, however, U.S. defense rights terminate abruptly. Article IV of the Neutrality Treaty pledges both parties "to maintain the regime of neutrality," but Article V allows only the Republic of Panama to "maintain military forces, defense sites and installations within its national territory". Apart from expeditious transit for its warships, there is no provision in the Neutrality Treaty that gives the United States preferential defense rights or that expressly permits a unilateral U.S. decision to intervene militarily in defense of the Canal.



Nevertheless, the position of the United States, as set forth in hearings of the Senate Foreign Relations Committee on September 26, 1977, is that Article IV gives the United States the right of armed intervention to protect and defend the Canal in virtue of its status as a joint guarantor of the neutrality regime. Defense Secretary Brown has stated (Senate hearings of September 27, 1977) that the United States has the "unilateral right to defend the Canal against any external threat," and both the State Department Legal Advisers and Attorney General Bell have unequivocally asserted the unilateral right of the United States to intervene militarily in the event Panama failed to maintain a regime of neutrality. (In the Senate hearings of September 26, 1977, Secretary Vance stated that Panama also has this right of unilateral decision and intervention).

The U.S. interpretation was at first rejected by both the chief Panamanian negotiator, Romulo Escobar Bethancourt and Labor Minister Adolfo Ahumada in speeches before the Panamanian National Assembly on August 19, 1977, which expressly denied any right of U.S. military intervention. Panamanian support for the U.S. interpretation now rests on an informal statement by President Torrijos at the signing ceremony that the Neutrality Treaty leaves the parties "under the umbrella of the Pentagon"; and by the concurrence of President Torrijos in an unsigned Statement of Understanding between the United States and Panama, dated October 14, 1977, to the effect that: \* \* \* each of the two countries shall \* \* \* defend the Canal against any threat to the regime of neutrality, and consequently shall have the right to act against aggression or threat directed against the Canal or against the peaceful transit of vessels through the Canal." What standing these would have in 2001 A.D. is an open question.

A separate question is whether the U.S. interpretation conflicts with its pledges for renunciation of military force and unilateral intervention in the U.N. Charter, the OAS Charter and the Rio Pact.

#### *Sea-level canal*

Article XII provides in effect that the United States shall have the exclusive right either to add a third lane of locks to the existing Canal or to dig a sea-level canal within the territory of Panama. In return, however, the United States undertakes not to negotiate with any third state for the right to construct an interoceanic canal on any of the routes in the western hemisphere unless Panama agrees—an unprecedented and probably unconstitutional restriction on the constitutional powers of the presidency in the field of foreign affairs.

Mr. METCALFE. Now, we recognize Mr. Modglin with some questions and, in view of the fact that both you, Mr. Maechling, and Mr. Baxter have answered most of these questions, we will just deal with the most important ones, and because of the time constraints there may be some remaining questions which we will submit to you later. If that is agreeable, Mr. Modglin?

Mr. MODGLIN. Mr. Chairman, I will be brief and summarize the most important questions to see whether the panel has any additional comments on them.

The first question addressed to the panel to which they responded was a comparison of legal guarantees in the present treaty arrangements under which the canal is run as compared to the guarantees under the proposed treaties.

Some of the comments have already been made. Does the panel have any additional comments to make on that?

Mr. BAXTER. Not from me, sir.

Mr. MAECHLING. No, sir. My comments are in the record and have already been summarized on that point.

Mr. MODGLIN. The third question posed was if the proposed Neutrality Treaty guarantees of nondiscriminatory treatment and reasonable tolls are violated, what remedies are available to the United States, that it might seek relief, and how would such remedies compare with those available under the present treaty relationship?

Mr. BAXTER. If I may respond to that, sir. It seems to me that this is the particular context in which one ought to think about some sort of compulsory third-party dispute-settlement mechanism. That which is possible with respect to the Suez Canal should be possible for the Panama Canal. I realize that for the moment, with the United States as proprietor of the canal, the United States probably would be on the receiving end of any complaints; but still that very circumstance, with the possibility of bringing some complaints, would mean the development of law on the subject. As of the year 2000, the United States will be purely in the role of a user of the canal and therefore would be in a position of wanting to have good strong remedies to be applied against the Republic of Panama in case anything went wrong.

Mr. MAECHLING. My view differs a bit on that from Professor Baxter. Where the shipping community is concerned, I think the question of remedies is to some extent a bit theoretical as I point out in my text: Vessels are pretty much at the mercy of the canal proprietor and can only obtain redress through the flag state.

Now, the flag state has the choice of either proceeding through force or diplomacy or mediation. Otherwise, it would have to proceed at rather a national basis through the world court. The whole standing of third party states, I certainly defer to Professor Baxter on, but again, I have the feeling that this is somewhat theoretical.

The United States has taken the position that, for example, that the Panama Canal does not have international status in comparison to the Suez Canal which it says does have international status. We have exercised right as a belligerent and we are both a belligerent power and control the canal as both canal proprietor and the littoral state which indicates, certainly, as a belligerent, we don't regard the treaty as dedicated to the world community.

The Suez Canal has been a bit different. Britain, for example, during the Ethiopian crises of 1936 had every opportunity to use the Suez Canal as a choke point and could have effectively stopped the Italian invasion of Ethiopia but did not choose to do so. So, I believe from the standpoint of the maritime community, whatever remedies existed would have to be handled through the flag state and they would simply have to spend their own interests during that period.

Mr. MORGAN. Question 6 posed to the panel indicated that the article I of the proposed Neutrality Treaty stated in part that the Republic of Panama declares the canal to be an international neutral waterway, permanently, in accordance with the regime established in the treaty. The thrust of the question was to relate what neutrality meant to the actual regime to implement that. I think Professor Baxter addressed that partially.

Mr. MAECHLING. I have no comment on that other than as in my text.

Mr. BAXTER. As I indicated before, sir, the term neutrality can be misleading. I think what is important is to look to the actual régime established—what are the rights and duties of the various states involved.

We know that in the past oceanic canals have been used as choke points—in Mr. Maechling's phrase—when the proprietor of the canal has been engaged in war. The duties of neutrality are primarily ones imposed upon the users of the canal, to make sure that they don't



cause trouble in connection with the transit of the canal when they are at war.

Mr. MODGLIN. Yes. Eight and nine—addressed to the panel—concern other U.S. international obligations in connection with the U.N. and OAS Charter. The questions were how these agreements might relate to the Neutrality Treaty, and is there anything in any of those agreements that might pose an obstacle to the implementation of payment of money to Panama in connection with the Panama Canal Treaty to the end of the year 2000?

Mr. BAXTER. My answer to that was yes, particularly as may concern the operation of chapter VII of the United Nations Charter, under the terms of which the Security Council could order the closing of the Panama Canal or the Suez Canal as a mode of compulsory pacification under the terms of the charter. This has never been ordered in the past. It still remains largely a theoretical possibility, it seems to me, because such a measure would be subject to veto by the United States.

So far as recommendations by the Security Council or the General Assembly might be concerned, these would not be the sources of binding obligations for states. The states concerned—the United States and the Republic of Panama and the users—would have binding obligations in the form of treaties; and the treaties would, I take it, prevail over the terms of recommendations by the Security Council and the General Assembly.

Nevertheless, candor compels me to say that Panama might yield to a resolution of the General Assembly or a recommendation of the Security Council and use that on some occasion as justification for closing the canal. I would hope not and think that it would not be really justified in doing so, but one must still take account of that rather remote contingency.

Mr. MAECHLING. I have no comment other than to associate myself with the comments of Professor Baxter.

Mr. MODGLIN. The final question that the subcommittee addressed to the panel. The general thrust of that question was whether or not the proposed Neutrality Treaty adequately protected user interests and what if any U.S. legislation might be necessary to help facilitate user guarantees for the canal?

Mr. BAXTER. Well, after listening to the testimony this morning about the tolls provisions, my confidence might be somewhat shaken. But I am no expert in that field nor am I an expert in accounting, and I have to defer to the views of those who spoke earlier in the day.

I think I would sum up my impressions of the situation by saying that the safeguards which are applied to the Panama Canal so far as international law is concerned are at least as stringent as those applied to the Suez and Kiel Canals and that the safeguards proposed under the new treaties go beyond the safeguards provided under the treaty of 1901 and 1903.

Therefore, there has been some forward movement in protecting the users. Perhaps we would have liked to have seen some further provisions in the agreement, but some improvement has been made.

Mr. MAECHLING. I do not quite agree with that, Mr. Chairman. Where specific user guarantees are concerned, I think the Suez Canal, at least on paper, offers the best guarantees. The existing arrangement—the existing Panama Canal Treaty—is the next best; and the

proposed Panama Canal Treaty the least satisfactory, largely because of the fact that the future canal proprietor will have no undertakings whatsoever to the world community.

Further, the guarantees that Egypt offered in its declaration are really much more complete as regards detail than anything that Panama will guarantee. I have, incidentally, attached the text of the Egyptian Declaration of April 24, 1957, as an appendix to my statement.

Mr. METCALFE. Thank you very much, Mr. Modglin.

I am informed that Professor Baxter is under a time restraint and his time has really run out. We hoped to have you out of here by 1:30 p.m., to meet your other obligations.

Mr. BAXTER. I should explain, Mr. Chairman, that my other obligations are to the students of the Harvard Law School, where we have a firm rule, applied even against the Congress, I might say, that the students come first.

Mr. METCALFE. Fine. I understand that and hope it would be agreeable with the staff that if we can permit any questions to you now they be any quick questions, that you may ask. The professor did ask to leave at 1:30 p.m., and it is past that time now. We certainly appreciate the professor's being here and giving us the benefit of his testimony.

Mr. Tannenbaum has one quick question.

Mr. TANNENBAUM. Without being unduly critical of the treaty negotiators—as we know, all agreements require give and take and every document has its flaws. Do you consider the flaws in the treaty critical to the extent and purpose—namely to improve our relationship with Panama and with Latin America—were you able to hear me?

Mr. BAXTER. I think I was able to catch it.

Mr. TANNENBAUM. Or, do you think they create so many new problems as to vitiate the very purpose for which these treaties are intended?

Mr. BAXTER. Well, there is no doubt in my mind at all, sir, that there are going to be problems in making this transition into the year 2000 and beyond the year 2000.

Two neighbors, as we are, cannot conduct very close relations without having certain sources of friction. What it is necessary to consider is what sources of friction there may be in these new arrangements, as compared to what might happen in the absence of these arrangements. I know now that I am venturing into the political sphere where I am not an expert, but my general understanding is that we will probably have a simpler and easier time with all of these problems which may arise out of the transition than we would have if we simply went on in the way that we have in the past. It is a question of comparison.

Mr. TANNENBAUM. Couldn't we have drafted a more exacting and precise treaty on, especially, certain very basic and vital issues like the basic economics of the situation, without creating a situation with endless disputes and controversy with our friends and neighbors in Panama.

Mr. BAXTER. Well, I think once again, from some experience of dealing with these matters, that it is sometimes impossible to resolve all issues in a treaty any more than it is possible to resolve all issues in



a statute and that one must leave some matters for the patient business of negotiation later on.

Again, it is a question of determining how much you can do in terms of the drafting of the treaty and whether you will attempt to resolve problems through the actual implementation of the treaty.

I would certainly hope that we can build some sort of a record on the treaty which would make it seem that there would be a pattern of cooperation rather than contention between the United States and Panama.

You may think this is rather mealy mouthed statement emanating from Cambridge, Mass., but nevertheless it rests upon a sincere conviction based upon some experience in both the government and the academic world.

Mr. TANNENBAUM. Is any agreement viable with the basic economics not clearly understood or where basic property descriptions are not spelled out or where basic rights of transit are not clearly and unequivocally set forth in the agreement where there is an understanding one way by one party and another way by the other party, and on very vital issues in the treaties?

Mr. BAXTER. I can agree with you completely. If we had greater clarity on a number of points, that would be splendid. I could sit down and improve this treaty no end as I attempt to do with my students. Nevertheless, that precision proved to be impossible, and I suppose that the pattern for the future will have to be one of cooperation between these two countries in phasing out U.S. administration and phasing in the Panamanian.

It is not going to be an easy time, but it would be even worse without the treaty. I agree that one could have drafted in the abstract a much better agreement, but I am inclined on these matters to defer to the experience of those going through the ordeal, year after year, of trying to negotiate out such a treaty.

Mr. METCALFE. Thank you very much, Mr. Baxter, and we certainly won't impose upon you and hopefully, you won't be late for the next class.

However, we will submit to you in writing any additional questions that you or any member of the staff may want to ask and we request that you answer those questions.

Mr. BAXTER. I would be very pleased to respond to those, Mr. Chairman.

Mr. METCALFE. Thank you. You may be excused if you wish.

Mr. BAXTER. Thank you, sir.

Mr. METCALFE. Thank you. We appreciate very much your testimony. Mr. Tannenbaum wants to pose the same question to Mr. Maechling.

Mr. MAECHLING. My view is a little different. I do not believe that the user guarantees are quite adequate as I indicated in my paper. My own view is that without making any really drastic change in the basic treaty, some of this could be corrected.

After all, the protocol could be, for example, revised or a condition could be attached to signing the treaties by the United States that Panama make some sort of unequivocal reciprocal declaration similar to the way that Egypt did with regard to the Suez Canal.

This would not mean that they would have to go back to square 1 on the language of the treaties. With regard to the toll question, concerning the general point made by Professor Baxter, I again disagree slightly—only slightly—but do think that the treaties, from the standpoint of interpretation, are looked at today too much from the way they appear and are explained by both parties today. The important thing is how will they be interpreted in the year 2000 when the Panamanian Government of the moment looks at the literal language of the treaties and Chief of Government Torrijos is dismissed as just one of the several dictators that were in power a whole generation earlier.

Mr. METCALFE. Thank you. Thank you very much.

Mr. Nonnenmacher, do you have a quick question?

Mr. NONNENMACHER. Unfortunately I haven't had the opportunity to read your testimony, Mr. Maechling, nor to meet you, but I want to say that I was very impressed by your article that appeared in the press at an earlier time.

In your oral testimony here, you have not referred to—and I was trying to see if you had in your prepared statement—to the point that Professor Baxter made. He thought the treaty negotiators used the word neutrality erroneously.

Would you care to comment on that?

Mr. MAECHLING. Yes. The fact is that, to start out with the current arrangement—the Panama Canal Treaty of 1903 uses the terms neutral and neutralization, and they are again repeated by reference to the Hay-Pauncefote Treaty—more than in the treaties that apply to the other two international canals.

On the other hand, the United States has taken the position that the Panama Canal is actually not all that neutral in time of war. We applied very stringent regulations on passage through the canal in both 1914 and 1939 before we had entered the conflict, and there is no question but that we would have suspended enemy transit through the canal in 1917, after we entered the First World War and in 1941, after we entered the Second World War. In fact, any notion to the contrary is really ludicrous.

Under the new treaties, the same assurances of neutrality are provided and, in fact, in much stronger terms, and I think that probably arguments could be made by other nations that the forthcoming treaties do indeed lead to a greater degree of neutralization than hitherto obtained.

Mr. NONNENMACHER. Yesterday, General Dolvin answered my question as to whether or not the treaties meant that warships of a nation at war with us could go through the canal and he said: "Yes, it did mean that."

We had been unable to get an answer to that question earlier, before the treaties were published back at our August 17 hearings. Ambassador Linowitz refused to answer that question.

So, in view of what you have just said, you concur with what General Dolvin said?

Mr. MAECHLING. I do, but I think in all fairness I ought to remind you of the testimony of General Brown in the Senate hearings, when he pointed out that the crucial factor here was that it was a choke point. He believed that the military strength of the United States



would always be sufficient to intercept any invading sea forces on either side.

Mr. NONNENMACHER. General Dolvin made that same point also. I would like to ask a question that was put on that same date, August 17, by Congressman Hubbard of Kentucky, and while I don't have it here verbatim, unfortunately, I think I can roughly phrase it in words that he used:

He asked would there be anything in the treaty that clearly showed our right to intervene in case there was a threat to the canal in such a way that the international community—the other nations of the world—would not find fault with the United States as making some sort of a colonialistic or imperialistic move.

Mr. Linowitz's answer at that point was that the word intervene would not be in the treaty and, of course, it in effect remained an unanswered question. My question is raised by Professor Baxter's definition or reference to the word neutrality and I did want to ask him the question but I deferred since he had to leave.

In view of this word neutrality having some different meaning, perhaps, as used in this treaty, do you foresee any possibility of world opinion at large descending upon us en masse if we indeed should have to go into the Canal Zone at a later date to stop some kind of aggression from external sources—first of all from Panama itself, and second—

Mr. MAECHLING. Yes, I foresee that. In fact, I think it is very likely.

I think, again, you look to the year 2000 and whatever governments are in control of the world at that moment, and look at the plain language of the treaty. There is simply nothing in those treaties other than a political guarantee. Then look at the interpretative statements and see that the right of intervention was expressly denied by the Panamanian negotiators on August 17 and 19, I believe, in their explanation to the Panamanian Congress.

You also look at the offhand language used by President Torrijos at the signing ceremony, saying something to the effect that we are under the umbrella of the Pentagon and at the unsigned statement, that adds very little, issued a month ago, after the Torrijos-Carter meeting.

I think you must see that the provisions against the establishing of U.S. forces or any other foreign forces in the Canal Zone, and the OAS Charter and the Rio Pact and so forth, will lead to a very strong interpretation that unless the right to intervene is squarely in the instrument, that it must have been intended to be excluded.

Mr. NONNENMACHER. I appreciate that.

Yesterday, General Dolvin reluctantly gave answer to a key question. I sought, I believe successfully, to get an answer to the remaining contradiction in the language of the Carter-Torrijos statement. Congressman Snyder requested and received from the American Law Division of the Library of Congress, an evaluation of the Carter-Torrijos statement and, in essence, the conclusion of the analysis is that while there is language allowing us to take action, there is also language forbidding any intervention in the internal affairs of Panama. Therefore, the analysis concludes, it remains unclear as to just what our rights are and what our course could be.

In several attempts I specifically asked the general what could we do were the threat to come from Panama's legitimate government or from Panamanian dissidents or terrorists. General Dolvin finally stated that we have the right to take steps, but he did not use and would not the word intervene. He said we have the right to take whatever steps are necessary to keep the canal open, regardless of the source of the threat.

Do you think that it is likely that Panama will agree to that publicly, and second, will that give us any further standing in the international community should we have to take such action against the background you just so very well set forth?

Mr. MAECHLING. The answer is, of course, that I don't know and all I was attempting to do was to set forth a probable interpretation by a Panamanian Government in a crisis in the year 2001.

I understand that the treaty negotiators felt that the formulation that they used, which although indirect and euphemistic, does provide a right of intervention; though, again, not in so many words—they think that this will do the trick.

I think that they are probably right from the standpoint of what we would do, but I am dubious about whether they are right from the standpoint of world opinion.

Mr. NONNENMACHER. Thank you very much.

Mr. METCALFE. Thank you, Mr. Maechling.

The subcommittee will now stand recessed until 2:30. p.m.

[Whereupon the meeting was recessed at 1:50 p.m.]

#### AFTERNOON SESSION

METCALFE. The hearing will come to order. The hearings on the financial meaning of the canal treaties would not be complete unless the subcommittee heard from representatives of the Canal Users.

We have several gentlemen with us today who, I think, will represent quite well the viewpoint of the U.S. canal users and their associates in the United States.

Before I introduce the panel, I want the members and the audience to know that we did try to get a Latin American trade representative on this panel to discuss canal finances and tolls, but we were unable to get such a representative to talk on these points.

Representing the American Institute of Merchant Shipping, which itself is the representative for the U.S.-flag oceangoing fleet, is Mr. James J. Reynolds. We are delighted to have Mr. Reynolds with us again. He has given us very helpful testimony in the past. I understand that Mr. James Amoss, chief of the Liner Council of AIMS, is accompanying Mr. Reynolds.

Mr. Herbert Haar is the associate port director of the Port of New Orleans, and in his position, Mr. Haar has spent considerable time pondering the relationship of trade in and out of New Orleans through the canal.

We welcome you gentlemen and ask that each of you read or summarize your statements and then the subcommittee will question you as a panel.

[The questions posed by the subcommittee prior to the hearing, and to which the witnesses responded in their statement, follow:]



## CANAL USERS AND ASSOCIATED GROUPS

1. It has been estimated that the provisions of the new treaties would require increases in rates of tolls of from 25 percent to 46 percent, or possibly more. Assuming increases in rates of tolls of that range, and subsequent smaller increases in future years:

a. What would be the effect on the traffic with which you are most closely associated through the Panama Canal?

b. For the Canal traffic with which you are concerned, what alternatives to the use of the Panama Canal are available?

c. How do such alternatives compare to cost of use of the Canal at present rates and at rates reflecting increases of 25 percent to 46 percent?

2. If it were clear that Canal toll rates would have to increase under the proposed treaty arrangement, what advantage to the maritime industry would result from a long-range projection of an approximate figure for a rate change by the Panama Canal Commission?

3. It has been said that users of international canals are primarily interested in the Canal's freedom of access, facility of passage, and reasonableness of transit charges consistent with proper Canal operation and maintenance.

Given this definition of user interests, what provisions of the proposed treaty package do you feel relate to each of these interests, and which provisions are, in your opinion, indefinite and need further clarification through a statement, implementing legislation, etc.?

4. At what point will you be priced out of the use of the Canal? What alternative will you resort to if you are priced out of Canal use?

Mr. METCALFE. Is there any one to accompany you, Mr. Reynolds?

#### STATEMENT OF JAMES J. REYNOLDS, PRESIDENT, AMERICAN INSTITUTE OF MERCHANT SHIPPING

Mr. REYNOLDS. Good afternoon, Mr. Chairman. Mr. Amoss, whom you mentioned, had to return to New Orleans, but Colonel Haar is here. Colonel Haar of the Port of New Orleans is here.

Mr. Chairman, my statement is fairly brief and I really think if you would indulge me, I would like to read it. I read fairly rapidly.

Mr. METCALFE. Proceed, Mr. Reynolds.

Mr. REYNOLDS. I would like to say, however, before I do, as far as I am concerned, I have appeared before many congressional committees and there is none that I would rather appear before than this one with you sitting there as chairman.

Mr. METCALFE. Thank you, sir.

Mr. REYNOLDS. Because I think you are such a credit.

Mr. METCALFE. We have a mutual admiration society.

Mr. REYNOLDS. Mine is a bigger one.

Mr. Chairman and members of the subcommittee, I am James J. Reynolds, president of the American Institute of Merchant Shipping, commonly known as AIMS. AIMS is the national trade association of the American-flag oceangoing merchant fleet and includes in its membership of 34 companies a number of whose tanker and cargo liner vessels regularly operate through the canal.

The primary interest of the shipowners represented by AIMS is in the continued safe and efficient operation of the Panama Canal by an entity which recognizes, and strives to maintain, this waterway's commercial viability.

AIMS has not adopted a position on ratification of the treaty and cannot intelligently do so until very critical matters bearing upon future toll structure and operation of the canal are clarified. We urge

this subcommittee to give serious consideration to our expression of concern and our suggestions as to treaty-implementing legislation which you may report to the House.

There is no question that the technologically advanced American-flag liner vessels which currently use the canal realize significant savings in so doing because of their relatively high daily operating costs and the disadvantage of utilizing much longer alternative routes.

If tolls under a new treaty are handled rationally as we will suggest most of these ships can be expected to continue transiting the canal. As to both U.S. and foreign-flag vessels carrying bulk commodities to or from the United States via the Panama Canal higher tolls may well price them out of the market and force them to construct very large, slow-speed bulkers sailing around the Horn to and from the United States. The impact on the canal's commercial viability of driving away traffic must be considered.

I would like to mention a few basic statistics to set the stage for our analysis of the present and future financial condition of the canal: In fiscal year 1976, approximately 117 million tons of commercial cargo passed through the canal.

Two-thirds of this amount—or 78 million tons—originated in or was destined for the United States. The long-term trend has been for canal traffic and tolls revenue to continually increase, although the experience of 1973-76 does demonstrate the relevance of world economic conditions to canal usage.

The canal can handle considerably more traffic than it presently does and increases in transits and revenue are projected, given reasonable stability of tolls. There is also an immediate expectation of a half-million barrels a day of Alaskan oil yielding \$36.5 million in annual toll revenue at existing toll rates, although this is expected to be a relatively short-term gain pending approval and construction of pipeline facilities.

I cannot emphasize too strongly, however, the fact that the continued commercial attractiveness of the canal to American and foreign-flag vessels alike depends on keeping tolls reasonable and the waterway operative. I indicated that most of the high-cost advanced-technology ships would probably continue to use the canal with moderate toll increases.

However, as tolls increase and freight surcharges become necessary, shippers will seek alternative routes for their cargoes. Some services, in response to recent increases, are already being replanned to utilize the Suez Canal, which has a clearly enunciated policy of setting tolls to be competitive.

Our intercoastal and east coast-Orient trades are particularly susceptible to shipper reaction to higher costs and if tolls are unreasonably increased, cargo will increasingly find its way across the continental United States by rail. The land and minibridges will become increasingly attractive to shippers of goods, to the detriment of a strong U.S. merchant marine.

Finally, this subcommittee should be aware that American-flag vessels as a group would tend to lose more cargo than foreign-flag vessels if the canal is priced out of their reach and they are forced into trades in which they are not competitive.



Most American-flag ships which use the canal are container ships. The average container ship pays about \$20,000 to transit the canal, which is roughly equivalent to an average day's operating costs. On shorter voyages such as west coast of South America to North Atlantic ports, where the percentage increase in voyage time by an alternative route is the greatest, the impact of rerouting to avoid the canal would be particularly devastating.

Turning to the proposed treaties, we see that the canal faces two distinct time periods—the period between now and the year 2000 and the post-2000 period. Article III of the Neutrality Treaty, our guide to the latter period, lists the following rules for purposes of:

The security, efficiency, and proper maintenance of the canal:

(a) The canal shall be operated efficiently in accordance with conditions of transit through the canal, and rules and regulations that shall be just, equitable and reasonable, and limited to those necessary for safe navigation and efficient, sanitary operation of the canal;

(b) Ancillary services necessary for transit through the canal shall be provided; (c) Tolls and other charges for transit and ancillary services shall be just, reasonable, equitable and consistent with the principles of international law.

We would not take issue with this statement of intent. However, the administration of the canal after the year 2000 will be an irrelevant matter if its handling during the remainder of this century results in the diversion of traffic to alternative routes and the emergence of new supply patterns not requiring the canal.

For this reason, we intend to concentrate on the period prior to the second millenium and address those provisions of the main treaty affecting vessel operations through the canal while it is still to a considerable extent under U.S. management.

I would first like to make a few general comments, Mr. Chairman, on some of the articles before getting into our specific recommendations for unburdening tolls through legislative changes.

Article III allows the United States to effect appropriate capital improvements to the canal and assess tolls through a Panama Canal Commission. We note the absence of specific procedures for arriving at toll rates and strongly urge that such procedures are needed to insure, at a minimum, proper consideration of user views.

Article III also sets \$10 million per year for the first 3 years as the amount the United States will pay Panama for providing police, fire protection, street maintenance and garbage collection.

Additionally, Panama will provide services of a general governmental nature such as customs and immigration, postal and judicial systems. We would expect that the substantial savings to present Canal Zone Government costs that result from these changes will be reflected in the tolls base.

Article X requires preferential treatment for Panamanians having the skills and qualifications required for employment with the Panama Canal Commission. Some review mechanism may be desirable to insure that the training programs which are also required are adequate to maintain the professional skills needed to operate the canal.

Article XIII sets out the economic relationship between the United States and Panama pending the complete transfer of the canal: "In operating condition and free of liens and debts." on December 31, 1999. It calls for the United States to pay Panama 30 cents per Panama

Canal ton annually, with adjustments indexed to U.S. wholesale prices for manufactured goods or a mutually accepted alternative. It also calls for a \$10 million annuity payment and up to \$10 million more to the extent canal profits allow.

The treaty negotiators have emphasized that none of these payments will be borne by U.S. taxpayers, conveniently overlooking the fact that U.S. consumers in effect pay most of the tolls.

Presently the United States pays Panama an annuity, sometimes called rent, of \$2.3 million primarily out of the State Department's budget, which is the only appropriate way to fund a government-to-government payment made for reasons of diplomacy.

We are concerned that these article XIII provisions may be overly ambitious politically and economically unsound. The canal has never been operated as a profit-making enterprise and to transform it into one now could well be counterproductive, dashing Panamanian hopes for a financial windfall.

We have heard predictions from the State Department that the tolls may be increased by 25 to 46 percent at the outset to meet the payment provisions of the new treaty.

Our inquiries as to the basis for his calculation have led us to believe that the U.S. Government has given insufficient attention to the canal's financial situation. We have a few suggestions for mitigating what we believe could be a very detrimental impact on the future of the canal, resulting from overburdened tolls.

Some of these suggestions will sound familiar to this committee as they were part of H.R. 12641, legislation which you developed in the last Congress and which unfortunately was not enacted. They are all based on the principle that tolls should cover only direct capital and operating expenses.

Canal users are presently required to pay interest on the Government's undepreciated net investment in the Panama Canal Company. In the recently closed fiscal year, this amounted to \$18.1 million. Certainly the time has come for tolls to be relieved of this burden.

At a minimum, the Canal Company should have this interest payment offset by receiving interest on its considerable cash balance in the Treasury.

Users have also been required to assume an ever increasing proportion of the nontransit related expenses of the Canal Zone Government. This burden on tolls in fiscal 1977 was \$21.1 million.

Under the proposed treaty many civil responsibilities will be transferred to Panama and will be performed at that country's expense. This is appropriate and should result in significant savings.

We urge that the cost of any governmental functions remaining with the United States not directly related to the operation of the canal be excluded from the tolls base.

The treaty lists activities which may or may not be performed by the Panama Canal Commission. For example, the Commission may not carry on commercial functions such as maritime transportation for the general public.

We are not clear what this does to the very costly, inefficient practice of having the venerable SS *Cristobal* operate a service which could be performed at far less expense by commercial vessels. Certainly this



committee should not approve any implementing legislation which charges users for losses incurred by the *Cristobal*.

Finally, any implementing legislation should bring to a halt the accounting policy initiated in 1973 when the Company began depreciating over a period of 40 years the value of the 1903 Panama Canal Treaty, the original excavations and other items totaling \$332 million. The resulting annual depreciation charge of \$8.3 million has been wrongly included in the tolls base and should be terminated.

If these suggestions are adopted and the present staggering burden on the toll structure is materially lightened, it may be possible to meet our obligation to Panama under the proposed treaty, within the existing toll structure.

The record of this Subcommittee in its hearings July 25 to 27 of this year amply demonstrates that alternatives to the canal exist and will be employed if tolls increase much more than the over 50 percent already imposed on users over the last 3 years.

There is no excuse for unnecessary tolls increases. Not only is the long-term health of the canal at stake, but also the American consumer would be adversely affected to the extent cargo does not move by the most cost-effective method.

Mr. Chairman, AIMS and others who have an interest in the long-term health of the canal are most disappointed that the administration is still not able or willing to unveil its detailed legislative proposals for implementing the operational provisions of the proposed treaty. It is somewhat puzzling that the executive branch seems to have a large number of experts who apparently have the time and inclination to travel the width and breadth of our Nation extolling the merits of the treaty, and yet they have been unable to assemble a comparable group to review the toll structure to consider all of the economic aspects involved, and to put a package together in time to meet this subcommittee's well advertised hearing schedule.

Perhaps we should put on our charitable hats and assume that they are awaiting an opportunity to review the record you are making here and give fair consideration to our views. But in the event—remote though it may be—that this is not the case, our industry must reserve the right to reappraise its position of neutrality on the treaty's possible ratification.

We don't want to get involved in any emotional discussion of the Panama Canal Treaty. I think ship operators are no different than people throughout industry and the public. All of them are Americans and if they can see some of these areas of concern to fundamental use of the canal adequately handled and have some assurance of reasonable stability and rational procedures for justifying rates, I think you are going to find that they are going to come around and support this treaty, and I hope that will be the case.

But, unless this is done, not only U.S. shipping industry, but, I believe, the world shipping community will oppose the treaty, which will be most unfortunate.

Thank you, Mr. Chairman.

Mr. METCALFE. Thank you very much, Mr. Reynolds. You have certainly brought a fresh perspective to these hearings that we have held in your realistic approach to the finances and that is the purpose of

these hearings to look at the economic aspects and the finances of the treaties. We certainly appreciate your presentation.

Mr. REYNOLDS. Thank you.

Mr. METCALFE. Mr. Haar, do you have a statement to make? Do you wish to summarize your statement?

**STATEMENT OF HERBERT R. HAAR, JR., ASSOCIATE PORT  
DIRECTOR, PORT OF NEW ORLEANS**

Mr. HAAR. I would like to present all of my statement.

I am Herbert R. Haar, Jr., associate port director, Port of New Orleans, and I am presenting this statement on behalf of the Gulf Ports Association, Inc. (GPA), the Mid-Gulf Seaports Marine Terminal Conference, and the Port of New Orleans.

Six States and 23 individual ports are represented by the Gulf Ports Association, Inc. Collectively these ports are moving 38 percent of all waterborne commerce in the Nation—over \$30 billion in world trade. These ports also export over one-half of all grain exported from the United States of which approximately one-third moves overseas via the Panama Canal. Additionally, Port of New Orleans is the No. 1 importer in the United States of iron and steel products and 87 percent of these imports arrive via the Panama Canal. U.S. Customs revenues collected from gulf ports amounted to more than \$450 million in 1975. Telegrams sent to the President and all Members of Congress by the president of the Gulf Ports Association and the chairman of the Mid-Gulf Marine Terminal Conference—Ports of Baton Rouge, Beaumont, Galveston, Gulfport, Houston, Lake Charles, Mobile, New Orleans and Orange—on September 28, 1977, in opposition to proposed increased tolls under the new treaty are attached for the record to this statement.

Considering the fact that the ports which belong to the Gulf Ports Association, Inc. have invested approximately \$1 billion in facilities to accommodate trade and U.S. revenue collections of such magnitude, it is deemed proper that these same ports should have a voice in the final terms approved for the new Panama Canal treaty.

In regard to answers to the four questions under the canal users and associated groups that you asked me to address, I will attempt to provide responses in a broad sense only. Detailed information can only be furnished by individual steamship companies and associations such as the American Institute of Merchant Shipping. I have checked with a number of other major ports in the gulf, a major grain exporting company, and several of our overseas Port of New Orleans offices in developing the material that follows.

The major commodities to and from our area that would be impacted by an increase in tolls are petroleum, coal, grain, steel and bauxite. I have been told just this week by the port director in Galveston, Tex., that his port is looking at the importation of large quantities of Australian coal in the future on 60,000 dwt ships. He also stated that inasmuch as the State of Texas is now planning for all industries, where practical, to convert to coal that there will be an importation of coal to Texas in the order of 50 million tons or more per year by the 1985-90 time frame. It is anticipated that a large part of this will be



import coal and possibly from Australia. On the other hand, the port director at Mobile, Ala., stated that his port has one large exporter of coal who shipped 2 million tons in 1976 to Japan who is most concerned with the competitiveness of his coal with Australian and Canadian coal on world markets with the projected increases in tolls through the Panama Canal. Oil from the North Slope in Alaska is projected to move by supertankers to the west coast of Panama and then be off-loaded for transshipment to gulf ports. Higher tolls in the canal could easily upset the economics of this operation and speed the alternative shipment of this oil by pipeline from southern California ports. This, in turn, would reduce one of the major sources of revenue for the Panama Canal which, in turn, would force the tolls upward even further in order to fund the \$70 million a year payment to Panama by the United States.

I have already touched on the size of grain movements from the Gulf ports and these movements, I am told from a number of sources, are most sensitive to competitive pricing with grain grown in Brazil, Argentina, Canada and Australia. The world grain market works on a spread based on the commodity price itself and freight cost. Anything that increases the freight reduces this spread. Therefore, any significant increase in overall grain prices, as a result of increased tolls and new Federal inspection costs could result in important changes in the U.S. share of the world market for various grains that we have traditionally exported in very large quantities and which are helping to offset some of our balance of payments deficit.

The Port of New Orleans' overseas offices report that a number of countries that we traditionally trade with in Latin America may search for suppliers and markets in countries that have transportation connections without the use of the Panama Canal, if they are faced with substantially high oceangoing costs as a result of Panama Canal toll increases. A number of major steamship lines are studying the potential impacts of toll increases and are looking at alternatives to present routings which will have the effect of both reducing the use of the canal and raising the costs of higher alternative routings of their traditional business.

In regard to the question on the advantage that would result to the maritime industry from a long-range projection of an approximate figure for rate changes by the Panama Canal Commission—I believe that this would be most helpful. It would provide a guide to our trade development offices on how to handle their future business development activities according to what the marketplace would support.

In regard to your third question about the canal's freedom of access, facility of passage, and reasonableness of transit charges consistent with proper canal operation and maintenance, all are covered by articles 1, 2, 3, 4, and 6. Notwithstanding this coverage in the treaty concern has been expressed by some of our overseas contacts and by some gulf port shippers on the guaranteed availability at all times of the canal once it is not under the full control of the United States. I would say that this feeling represents a lack of confidence in Panama always keeping the canal open once the treaty is consummated and a lack of confidence of the United States willingness to enforce any requirement on the Panamanians to do so.

Your final question pertains to being priced out of the use of the canal. I think that this is a question more appropriately answered by the American Institute of Merchant Shipping. I do know from my previously mentioned contacts that a number of steamship lines are making private estimates as to when this occurs in their individual situations and are planning on less costly alternatives for handling their business at that time. This will certainly impact both on the future utilization of the canal and on the cost of the commodities involved to the consumer. You should also keep in mind that the Congress next year will enact waterway user charges in the United States which will further affect the competitiveness of our exports in world markets.

It is not merely a local adverse economic impact with which we are concerned. We feel that new major increases in Panama Canal tolls will have an adverse financial impact on the interior of the country, on international business, on our balance of foreign trade and on our energy problems—all of which are of national concern. We, at the Port of New Orleans, and throughout the State of Louisiana are keenly aware of the adverse economic impacts which will accompany further Panama Canal toll increases because we sit at the crossroad of America's inland waterway system.

The Port of New Orleans, due to its geographical location near the mouth of the Mississippi River and at the crossroads of the Gulf Intracoastal Waterway services the midcontinent of North America. Historically, it has gathered the products of mid-America and shipped them overseas in deep draft bottoms and in return, distributed the products from overseas to the industries and cities of the midcontinent. Its geographical location makes it the natural gateway for the commerce of mid-America and also makes it logistically all important in times of war and imposes on it major defense responsibilities.

In order to put the Mississippi River system into perspective, let's look at some statistics. The U.S. port industry handles approximately 1.8 billion tons of commerce annually. The total tonnage of commerce moved on inland waterways is approximately 600 million tons annually. The net inland traffic on the main channels and all tributaries of the Mississippi, Illinois, Missouri and Ohio Rivers is 300 million tons annually. Inland traffic on the Gulf Intracoastal Waterway, which connects with the Mississippi River at New Orleans, annually exceeds 100 million tons. The inland waterway system described above connects to an oceangoing transportation system 200 miles from the Gulf on the Mississippi River at Baton Rouge, La. Below Baton Rouge the river has natural depths exceeding 120 feet and widths exceeding 2,000. In this stretch of the Mississippi River, we find the Port of Baton Rouge, fourth largest in the nation, and the Port of New Orleans, second largest in the Nation. Traffic in this oceangoing segment of the Mississippi River system is intense. In 1975, traffic on the Mississippi River from Baton Rouge to, but not including, New Orleans totaled 201,600,768 tons and traffic on the Mississippi River from New Orleans to the mouth of Passes—Gulf of Mexico—totaled 203,134,329 tons. Thus the total traffic on the oceangoing portion of the Mississippi River system in 1975 was 405 million tons, which is equiva-



lent to two-thirds of the total U.S. inland waterborne commerce. In 1975, the value of the trade on the lower Mississippi was \$19 billion. In 1975, there were 13,366 oceangoing vessels and over 90,000 barges moving on waterways through the New Orleans area. The total value of all foreign trade in the lower Mississippi is \$19 billion—export and import—the major commodities are grain, petroleum and petroleum products, iron and steel, machinery and paper.

The estimated \$22 billion worth of agricultural commodities and products exported during the fiscal year ending June 30, 1976, is a tribute to the energy, sales ability and traditional trading spirit of the American agricultural community.

Exports provide markets for nearly 60 percent of the U.S. annual wheat crop; 55 percent of the rice; half of the soybeans; more than one-third of the cotton and tobacco; and one-fourth of the feed grains we produce.

About one-fifth of 1975 farm cash receipts resulted from agricultural exports. Production from nearly one out of every three harvested acres is sold abroad. Because of balance of payment requirements, U.S. land devoted to export crops and livestock is increasing by millions of acres annually.

The vast network of support and service companies and organizations that link American farms to consumers beyond our borders benefits from exports. Businesses that include agricultural machinery and chemicals manufacturers; the packaging and container industries; the transportation system; international banks; forwarders; brokers; and the small army of marketers, promotion specialists; and commercial representatives who travel the world probing for new or expanding markets for American farm products, all benefit from exports. Every additional billion dollars realized from an export sale generates 50,000 additional jobs at home.<sup>1</sup>

Movement of a substantial portion of the total annual agricultural exports to world markets occurs via ports on the Gulf of Mexico.

It is strongly recommended that the Senate not ratify the new proposed Panama Canal treaty unless it is amended so that there will not be an adverse economic impact on American shipping and the American consumer. We strongly feel that our foreign trade and balance of payments cannot stand, without major adverse impacts to the national interest, the reported 25- to 46-percent increase in tolls for the Panama Canal after ratification of the subject treaty. In event the Senate sees fit to ratify this treaty then we recommend that it do so with the stipulation that tolls will not be increased to pay the nonoperations costs portion of the new increased annual payments to be made to the Government of the Republic of Panama.

GULFPORT, MISSISSIPPI, September 28, 1977.

To: The President of the United States, the Members of the Congress.

MR. PRESIDENT and CONGRESSMEN: The Gulf Ports Association, an organization representing the public deepwater ports of the States of Alabama, Florida, Louisiana, Mississippi and Texas through whose facilities over one-half of all grain exports from this United States move and through whose ports some 37.8 percent of all U.S. cargoes move in international trade and commerce, sincerely and vigorously urge that the Panama Canal Treaty not be ratified and become

<sup>1</sup> Source: Food and Agricultural Export Directory, USDA, Foreign Agricultural Service, May 1976.

effective unless and until realistic, effective and controllable safeguards are effected to assure fair, equitable and economically realistic canal tolls, rates directly related to the operation and maintenance of the canal, and not including the cost of international diplomacy. To burden the cargos and vessels transverseing the canal with the additional and very substantial non-operations costs of payments to the Government of the Republic of Panama can have an extremely adverse effect on not only the canal movements, but can well price certain U.S. exports which can not economically utilize other routings out of world commerce. The effect on all of the United States ports located on the Gulf of Mexico could be dramatically detrimental unless rates and tolls are maintained at a level commensurate with the costs of canal operation.

Respectfully,

ROBERT C. ENGRAM,  
*President,*  
*Gulf Ports Association.*

MID-GULF SEAPORTS MARINE TERMINAL CONFERENCE,  
*New Orleans, La., September 28, 1977.*

To: The President of the United States, the Members of the Congress, and the Secretary of Commerce.

MR. PRESIDENT, CONGRESSMEN AND MADAME SECRETARY: The members of the Mid-Gulf Seaports Marine Terminal Conference whose facilities handle annually over 13,600 ocean-going vessels engaged in international trade and commerce most strongly urge and request that the Panama Canal Treaty not be ratified until and unless provisions are made to limit tolls and charges at the Panama Canal to that level needed to defray operating, maintenance and capital costs of said facility, and that the maritime trade and commerce of the United States of America not be burdened with the costs of international diplomacy, expenses that are completely unrelated to the economic cost of providing cross-Isthmus passage of vessels and cargoes. The costs of payments to the Government of the Republic of Panama, if met by increased Panama Canal tolls, may well result in decreased use with a resultant decrease in total canal revenues as well as burdening specific American exports, especially grain and machinery moving to the far eastern, Asiatic and Pacific nations, to such an extent as to price them out of world competition thereby depriving our Nation and its economy of the largest and best source of foreign exchange and income so vital to a favorable balance of payments.

Respectfully,

EDWARD S. REED,  
*Chairman,*  
*Mid-Gulf Seaports Marine Terminal Conference.*

Mr. METCALFE. Thank you very much, Mr. Haar.

I would like to ask both you, Mr. Haar and Mr. Reynolds: Have you had an opportunity to present your views to anybody other than the Subcommittee on the Panama Canal, any other committee, or have you had any discussion? Have you had an input that went into the negotiators as to similar material that you have presented to us here this afternoon?

Mr. REYNOLDS. Mr. Chairman, speaking for the American Institute of Merchant Shipping, the answer is no, with this exception. I had hoped, prior to the conclusion of the treaties, that we would have had an opportunity to probably have some informal discussions with the chief negotiators, but the pressure of time and the pressures on them made it impossible for them to do this. After the treaties were negotiated, and I heard Mr. Linowitz and Mr. Bunker who had worked so diligently on the treaty make statements before this House committee and before the Senate Foreign Relations Committee, which included rather I think cavalier-like references to immediate increases in tolls of a very substantial amount, I did discuss them with Mr.



Linowitz and Mr. Bunker. I expressed the deep word of caution to them that they were proceeding on a false assumption that tolls could be materially increased without injury to the continued growth of transits, or without seriously injuring, in our case, the American Merchant Marine.

Ambassador Bunker particularly could not have been more courteous and willing to listen. I stressed to him what we viewed as a terribly important matter and that is to see to it that any implementing legislation which the administration recommended to you people included steps to relieve the present tolls from the staggering burdens that they carry. For instance, adding together that \$18.1 million in interest, and \$21.1 million in the costs of the zone government, and the \$8.3 million in peculiar depreciation of treaties and excavations, which were not depreciated until some 4 years ago, they amount to \$47.5 million. If you had new revenue from Alaska oil for the next 5 or 6 years of \$36.5 million, you are talking about a total revenue of \$84 million that will be available.

But these things have to be addressed by the administration and the Congress.

I think that there is the possibility of structuring this whole treaty arrangement and the whole orderly transition in a manner which indeed can avoid excessive toll increases. But I have only had that opportunity, and this is the first opportunity to come before a congressional committee for which I am obviously deeply grateful to you.

Mr. METCALFE. Mr. Reynolds, what was Ambassador Linowitz's reaction to your presentation?

Mr. REYNOLDS. Ambassador Linowitz' reaction was, well, we proceeded on the validity of the Stanford research study. This is the study that was referred to this morning. The earlier study in which I believe Mr. Brandes participated, which was based fundamentally on a widespread inquiry of shippers—not ship operators, but shippers of goods, importers and exporters—which concluded that tolls could increase, as Mr. Linowitz told me, as much as 85 percent from the level they then were without destroying the economic viability of the canal. I told him we seriously challenged the validity of the study, urged that it be updated. They have responded to this request. We also asked that they include in their study careful inquiries with responsible ship operators of tankers, bulkers, cargo liners, both American and foreign which utilize the canal, so we are sure we do this thing in the right way so that we are not going to hurt the commerce of the world and more particularly that of the United States, and that we give Panama honorably a vehicle and a means of national income which can be accomplished in a felicitous way to both countries.

I think he is attempting to respond to that.

Mr. METCALFE. Mr. Haar, I would pose the same question to you as to whether or not you have had an opportunity to relate this information or similar information to any other group or person, other than this committee?

Mr. HAAR. Mr. Chairman, on September 30, I was invited to appear before a subcommittee of the Senate Judiciary Committee. When I arrived in Washington, that hearing had been canceled on about 2 hours advance notice. They did take the same statement I presented here for the record and it was accepted for their record. Of course,

it did not contain the answers to the questions that you posed, which I have answered in this statement.

Also, we did send telegrams that I mentioned in my statement to the President and all Members of Congress, and in the past 2 weeks, Mr. Reed, the port director at the Port of New Orleans and also the President of Mid-Gulf Sea Ports Marine Terminal Conference, who signed one of those telegrams, did receive a response from a Mr. James C. Haar, Director of the Office of Panamanian Affairs in the Department of State on behalf of the President, to that telegram.

I would be happy to either read this letter into the record here now or furnish you with a copy of the letter for the record.

Mr. METCALFE. Mr. Haar, would you be willing to furnish that correspondence for us so that we can insert it into the record?

Mr. HAAR. Yes, sir. I would be happy to furnish a copy for the record. They are the only contacts we have had in connection with this subject, sir.

[The information referred to follows:]

DEPARTMENT OF STATE, *Washington, D.C.*

Mr. EDWARD S. REED,  
*Mctairie, La.*

DEAR MR. REED: The President has asked that I reply to your mailgram of September 28 concerning the new Panama Canal treaties. We appreciate having your views and share your desire that the new treaties not be detrimental to United States commerce. Our objective in negotiating the new treaties has been precisely to insure that a secure and neutral canal will remain available to world commerce over the long term.

Realistically, any new agreement, if it is to endure, must provide Panama a fair return for making its territory available for the Canal, as well as offer Panama an economic stake in the efficient operation of the Canal. It is for these reasons that we have agreed in the new treaties to provide Panama with a share of the Canal revenues.

In negotiating the new treaties we have arranged that payments to Panama be set at a level that would not require increasing tolls to the point that the financial viability of the Canal enterprise would be endangered. While we anticipate that a toll increase will be necessary, we do not expect, on the basis of extensive studies, that the increase would be of such magnitude as to constitute a burden on United States exports.

Sincerely,

JAMES C. HAAR,  
*Director, Office of Panamanian Affairs.*

Mr. METCALFE. Mr. Reynolds, we have heard that U.S. tankers and bulk carriers which transit the canal can pass on the cost of higher tolls to consumers. We have heard that the U.S. liners carrying diverse cargoes through the canal cannot pass on higher costs to consumers, but rather will be priced out of their market.

Would you comment on this?

Mr. REYNOLDS. Yes, I will, Mr. Chairman. I think it is a generally known matter that in the transportation of petroleum, which has been subjected to so much volatile change in price structure because of the crisis in the Middle East, the question of a 30-, 40-, 50-, 60-percent toll increase in carrying Alaskan crude through the Panama Canal, in relationship to the broader problems, becomes rather relatively minor and can readily find its way to the consumer.

The whole question of the conservation of energy, includes now suggestions that the price of home heating oil, gasoline, all the other products of crude oil be materially increased to encourage conservation, so



it encourages the view that in the carriage of petroleum through the canal the increase in tolls is not a major consideration because it will be readily passed on and indeed might very well be part of a whole program to increase the price to the consumer so he won't use so much, ridiculous as it sounds. But when you talk about the cargo liner, one carrying general cargo, let us consider a major company on the North Atlantic range of ports with a major service to the Orient, who loads his cargo in New York, Philadelphia, Baltimore, transits the canal, and goes on to Taiwan, Japan. Increases in tolls to him are a very serious matter because while the tolls, when taken in isolation, may seem relatively unimportant, when he is also faced, for instance, and it may seem irrelevant, but it is not, with a fantastic increase in cost by the recent settlement of the longshoremen on the Atlantic coast, and he is confronted with other increases in cost, all of these things put together make each additional 50 cents a ton, 7 cents a ton, or 30 cents a ton transport cost a matter of devastating competitive disadvantage, and he will lose his business.

Such services enjoy the confidence of major shippers and importers. They prefer an all-water route. They like the idea in the eastern half of the United States of putting their cargo in a box and locking it, because on a ship the box is handled once, and is taken off the ship in Yokohama or some place else in the Orient. While they like it, there comes a point where their liking it is tempered by the cost advantage of doing it otherwise. They will more and more go to the so-called mini-bridge, which would mean if their cargo originates, let us say, in western Pennsylvania, they will put it on trucks and railroads, take it to San Francisco, then put it on a ship to Japan. Someone will say what is wrong with that, as I did earlier. There is nothing wrong with that, except the American steamship line loses it. The only way he can carry it is in the highly competitive ruthless trade from the west coast to Japan and that is such a competitive trade that he ultimately is going to be forced closer and closer to the wall.

Mr. METCALFE. Thank you.

Mr. Reynolds, Mr. Steers said this morning that as long as the United States owns the canal, it ought to receive a return on its investment. If you do not agree with this, why?

Mr. REYNOLDS. If I understood that, that I do not agree with the statement that the government should receive a return on its investment through interest—was it that? I think it was, was it not?

Mr. METCALFE. Yes.

Mr. REYNOLDS. Mr. Chairman, let me make a statement, not as President of AIMS, but as a responsible American. I think since we originally built that canal for \$386 million, we renewed this and that, so that is where this capital expenditure comes, all of this must be depreciated, I think we have written off that canal probably 30, 40, 50 times in World War I, World War II, where this Nation was served so magnificently by it, in Korea, in Vietnam, and here we are talking about requiring the use of the canal, commercial users, to pay, as part of their tolls, interest on what is still owed to the United States at \$18 million a year.

I think it is utterly obscene, frankly. I think it is wrong. I think we ought to get over his peculiar arrangement of thinking that the commercial users should continue to pay interest. Keep in mind, Mr.

Chairman, that the Panama Canal Co. for years has had to have big deposits in the Treasury. Do you think they get interest on that? The answer is no. Your committee recommended that at least the interest be offset to the extent that this was logical and possible. That was rejected. For them to think that this interest is now going to be also charged on this phony 300 and some million which suddenly came out of the woods 3 and 4 years ago by saying for the first time now we will depreciate the treaties—who the heck ever put a value on a treaty? That treaty was priceless. It was priceless not a value of, say, 23 or 25 million. Your home, you depreciate the home, you do not depreciate the land it is sitting on because it keeps going up, but not the Panama Canal. We are expected to depreciate, depreciate that excavation, and pay interest on the portion that has not been depreciated by this arbitrary setting of a value on it, which all these items, total as I say, \$332 million, to be depreciated over 40 years, at \$8.3 million a year on tolls, interest on tolls, depreciation on tolls, net cost of the government on tolls, and then we are going to pay Panama 30 cents a ton, and \$10 million from tolls, and another \$10 million for police and garbage collection from tolls. You people are left with a terrible problem, as Mr. Linowitz and Mr. Bunker said, yes, this means major elements of the financial structure of the Commission are not specified in the treaty, but they are left for determination by the United States.

The United States is you, and you have to do these things. They left a pretty untidy job, despite the magnificent work they did for the country, and you have to tidy it up, or you might as well give the Panamanians Central Park Lake because they will not make a nickel on it in 20 years.

Mr. METCALFE. Mr. Reynolds, Mr. Brandes indicated this morning that in his sensitivity analysis, he has not studied the nontoll charges at the canal. I understand that nontoll charges for transiting vessels are about one-seventh or so of toll charges. Do you think nontoll charges are significant in determining whether a vessel will use the canal?

Mr. REYNOLDS. Actually, with greatest respect I would question those figures. In the fiscal year just past, I think you will find that toll revenue, that is for the vessels coming through laden at \$1.29 per canal measurement ton and \$1.03 going back in ballast, amounted to \$164 million, and canal-related revenue, that is your bunkage, tugboats, lockage, rope handlers, et cetera, amounted to \$122 million for a total cost of \$286 million, and total operating costs were \$281 million leaving a profit of \$5 million.

So to sum it up, I have never heard any of our operators complain about, one, efficiency of the canal and the courtesy with which they are handled by the Panama Canal Company and the way it is operated under General Parfitt or, two, have ever heard them complain about the charges for pilotage, tugs, rope handlers, et cetera. They are considerable, but I've never heard them complain. Their ships are handled safely, prudently, and magnificently. They are perfectly willing to pay those charges as they do today.

Mr. METCALFE. Thank you, Mr. Reynolds.

Mr. Haar, the Maritime Administration indicated yesterday that if canal traffic were to fall off due to initial toll increase under the



proposed treaty of 25 to 40 percent, that traffic would pick up again in future years. This would be due to the effect of inflation.

Do you agree with that?

Mr. HAAR. I tend to disagree, though I have not really studied that particular question. I just know from the inquiries I made in connection with preparing the answers to the questions that you asked be addressed at this hearing that a number of our overseas agents indicated there were plans being made by a number of steamship lines, and it did mention names, for what would be the point when they would no longer be able to operate efficiently in the canal due to tolls. So I would say when you are just talking about this range of increases, and there is concern of that type, because some major steamship lines are starting that type of planning there could be a feeling they could have problems and that they are concerned.

Mr. METCALFE. On page 4 of your statement you indicate that your approval of the idea of projection of possible toll increases. Do you like the idea of fixed but limited toll increases of the future as compared to an uncertain future with respect to tolls?

Mr. HAAR. We would much prefer to have some fixed schedule that is known in advance and is publicized in advance because our port and many other major ports in the Nation operate with an extensive network of not only United States but overseas trade development offices, so if we know what is going to happen in the future tollwise, and we can plan on what changes in trade patterns and flow of various commodities will happen as a result of this, I think we can better develop our business for the future in a way to minimize the impact on us insofar as that is possible.

So we are very much in favor of knowing what these tolls are going to be as far in advance as possible.

Mr. METCALFE. You heard Mr. Brandes say that 25 to 40 percent initial toll increase will not have a noticeable effect on any region or ports within the United States.

You do not agree with this, do you?

Mr. HAAR. No, sir, I do not. This disagreement is based on specific responses I have received to inquiries made in preparing for answers to your questions for this testimony.

Mr. REYNOLDS. Let me throw a little hypothetical at you, well, a real case at you. Fixtures for grain, selling grain, going to Japan, out of the gulf have recently been at a new freight rate of \$10 a ton from gulf ports to Japan. Forty percent increase on the present toll of \$1.29, that is 51.6 cents—well, let's be charitable and narrow it out to 50 cents, you are talking of a 20 percent increase in shipping cost per ton of American grain going to Japan. You are talking of 50 cents on the \$10, and competition from Australia, from Canada, is so close that that grain trade could disappear. This is not a dream in the future. This is a fact right now.

Forty percent increase in tolls would really mean a 20 percent increase in the cost of grain from the gulf to Japan because a measurement ton, which is really the cubage in the hold of a ship, is almost synonymous with the ton of grain, because it fills the space. It is not as if you have break bulk cargo—automobiles, machine tools, which would not fill the space. I'm sure you follow that. If you put bulk in there, you put coal, grain, you fill up the space. If its specific gravity is

such that roughly it equates to a ton of 2,240 pounds, which it does in many cases, what you're talking about is 20 percent increase in the cost of grain laid down in Japan. We have got to sell this grain and we are not going to sell it if, let us say, the 40 percent becomes 80 percent and it becomes ridiculous, and there is no more business.

Mr. METCALFE. Thank you.

Mr. Modglin?

Mr. MODGLIN. I will be very brief, Mr. Chairman, because I know you have a plane to catch, sir.

Mr. Reynolds and Mr. Haar, the *Journal of Commerce* in a recent edition of a new article entitled "New Canal Commodity Toll System" discussed an Economic Commission for Latin America proposal and concluded that if the Panama Canal went to a commodity toll system that tolls revenue could be tripled from up to \$600 million, they said, by 1980.

Mr. Brandes disagreed with their conclusions this morning. If we could get your comments on the record please on that matter.

Mr. REYNOLDS. Mr. Modglin, the whole idea seems to be appealing and very relevant to my response to the chairman before that toll increases on petroleum may be handled much more graciously, shall we say, than increases on automobiles or highly competitive imports and exports.

However, there would be problems involved with different toll rates on different commodities, which is what you are talking about rather than the concept of so much per measurement ton, which has been historic in the Suez Canal before the Panama Canal and then was adopted by President Teddy Roosevelt for the Panama Canal. The measurement-ton concept is, I'm afraid, so deeply established that any change to put a bigger burden on one commodity and less on another, logical as it may sound and appealing as it may sound in the abstract, would be just so complicated and pressures and objections of various economies around the world would be such that it just could not be done, I'm afraid. That is my response to it.

Mr. MODGLIN. Has not the St. Lawrence Seaway begun to develop such a system, and if so, what have the effects been?

Mr. REYNOLDS. I'm afraid I cannot answer that. The first part of your question is in the affirmative: yes. How it is working, I think there have been serious objections, but I would have to confirm that.

Mr. HAAR. In response to your first question, I would agree with what Mr. Reynolds has said. I feel there are so many different ways that shippers and people that have commodities to move can seek alternatives with modern technology—let us just look at the first super port coming on line off Louisiana in 1980, it is going to reduce the cost of moving petroleum by 10 to 50 cents a barrel, where new pipelines are located, will make a difference in terms of how petroleum is going to move in the future, whether a pipeline comes down through Canada or the midpart of the United States, they are all alternatives. How the Japanese handle their backhaul, for ships which traditionally move certain manufactured products one way through the canal and on up on the gulf and northeastern ports, and backhaul as a grain ship, if new prices are put on the tolls for certain commodities maybe they would change their routings and then have these ships make calls only on the west coast. Even though cost of moving grain out of the Pacific Northwest I think is a lot more, and there are



not the elevators there to handle it right now, there might be sufficient economics developed if these tolls got too large, say, on grain to encourage the further development of the Pacific Northwest area, even though it would involve a more expensive routing by rail, et cetera, to go out of the Pacific Northwest. Or the Canadians would step up their production of grain and export it from their western ports.

So, I think you are getting into a very dangerous area that would encourage people to seek out alternatives rather than pay these larger prices which looks so tempting when you talk about the traffic being able to bear it, because there is a fine margin where you can go so far, a certain percentage before you are going to drive business away, and someone tries to increase the tolls up to just that point.

Well, the people on the other side, who are shipping these commodities, they are figuring ways to hold their prices down. They are going to seek out alternatives and plan them and put them into play because the whole name of the game is to get the business and be competitive in world markets.

I think this could be self-defeating in my judgment.

Mr. MODGLIN. Thank you, Mr. Chairman.

Mr. METCALFE. Mr. Nonnenmacher.

Mr. NONNENMACHER. Thank you, Mr. Chairman.

Mr. Reynolds, in view of the fact that both Ambassador Linowitz and Governor Parfitt have told this committee yesterday that the canal company in conjunction with the State Department, to quote the Governor's words, are having an economic study performed "to forecast potential canal traffic and to determine the impact on canal traffic of various toll rate increases that may be necessary under the new treaties"; in view of that statement, do you think that perhaps they have put the cart before the horse, and made the promises of what they are going to pay Panama out of tolls without really knowing what the tolls can bear?

Is that the essence of your position?

Mr. REYNOLDS. I think it was the essence of what I was saying. I am so respectful of what Mr. Bunker and Mr. Linowitz did down there for the country, but I think that they felt the data they had from the previous study was sound and valid, and they proceeded on that basis. I think it is to their credit they have now activated an updating of their study to be sure they were right. And I think if they find they were wrong, they will take steps to inform you that their cavalierlike statements were wrong, that tolls will have to go up maybe 35 percent, but that will not hurt. Also before the Senate Foreign Relations Committee Secretary Brock Adams, again with respect, said "Well, tolls might go up 40 percent, but this will not interfere with traffic, it will keep going up"—this is nonsense, Mr. Nonnenmacher. It is not going to happen.

I do think it is to their credit that they are updating the study, and I would like to think it was partly in response to our alerting them to the fact that the basic data they proceeded with in the negotiations not really valid.

Mr. NONNENMACHER. Thank you.

Mr. Haar, in relation to your testimony I have one technical question.

On page 3 you mention significant increases in grain prices as a result of increased tolls and new Federal inspection costs.

Now, that matter, the Federal inspection costs, has nothing to do with our subject, is that correct, or am I mistaken? Is there now some Federal inspection cost involved?

Mr. HAAR. Yes. You know, as a result of the grain scandals, instead of the private sector in many areas handling their own grain inspection, the Federal Government has passed a law that inspectors will now be Federal employees.

Mr. NONNENMACHER. But this is a matter apart from treaty consequences.

Mr. HAAR. Yes. This is quite apart from the treaty.

Mr. NONNENMACHER. I just wanted to clarify that in case anyone reading the testimony—

Mr. HAAR. It is just additional cost on the grain that is now going on, because this is more expensive, I would expect in that way than it was before.

Mr. NONNENMACHER. I understand. I was very impressed by your statement on page 5 at the top, about the talk you had with people who are gulf coast shippers. The concerns they have expressed indicate to you a feeling of, first, a lack of confidence that Panama would always keep the canal open, and to me what was even more important, a lack of confidence in the U.S. willingness to enforce any requirement on Panamanians to do so.

I gather from this that the people you associate with just do not think Uncle Sam is going to take the necessary measures some day in the future if Panama does not quite live up to this agreement?

Mr. HAAR. That is exactly correct.

Mr. NONNENMACHER. That is a gut feeling of people in that area?

Mr. HAAR. I do not want to mention the area of the world, but it is a very specific answer, and there is considerably more detail in the answer that they would like to see done to provide additional safeguards.

I did not particularly want to publicize this particular country. Some of their top manufacturers and industrial leaders have made this comment. I did not want to pinpoint that particular country. I do have specifics on that.

Mr. NONNENMACHER. I got the impression these were Americans, mostly shippers—

Mr. HAAR. There are several American shippers, but also one foreign country that we do extensive business with that has this feeling too. We have them in both categories. I would be glad to give them to you privately, I would rather not put them in the record, for obvious reasons.

Mr. NONNENMACHER. On page 7 you mention very specific information, exports provide markets for nearly 60 percent of the annual wheat crop, 55 percent of the rice, and half the soybeans, et cetera. You do not mention corn. Have you got a figure on how much of our corn is exported?

Mr. HAAR. I do not, but I will be happy to get that and provide it for the record. [It is 28 percent (source USDA).<sup>1</sup>]

<sup>1</sup> Information added.



Mr. NONNENMACHIER. I would appreciate that. In that concern I would like to mention for the record, for anybody reading it at a later date, and for both of you gentlemen, that on July 25, James Boone, Director of the Office of Rail Economics and Operations of the Federal Railroad Administration, Department of Transportation, gave very concise testimony which upholds what both you gentlemen have given us. He specifies the increased competition from other countries in the case of wheat that Mr. Reynolds pointed out.

He discusses all of these exports. He makes the point about lack of grain facilities on the west coast that you have just a moment ago referred to, and the lack of coal handling facilities, all of which are very important.

The reason I asked about corn is that it is my understanding that recently Senator Culver of Iowa indicated that he was trying to protect the interests of his constituents in that State who grew corn, and that is why he was for the treaties.

I think it is important that we get your testimony on the record showing that, indeed, there is a threat rather than a help as the likelihood in the offing for those Iowans and other farmers.

I believe that is all I have. I would like to thank both of you gentleman for appearing before us and giving us this important testimony.

Mr. METCALFE. Thank you, Mr. Nonnenmacher.

Now we will hear from Mr. Tannenbaum.

Mr. TANNENBAUM. Thank you, Mr. Chairman.

Mr. Reynolds, on page 6 of your statement you state that the treaty negotiators have emphasized that none of these payments will be borne by U.S. taxpayers, conveniently overlooking the fact that U.S. consumers, in effect, pay most of the tolls.

I do not say this critically, because I think your statement is excellent, and I happen to agree with it, but are you not suggesting the same type of fiscal gimmickry by suggesting that normal and proper costs be eliminated, namely depreciation, interest on investment, and indirect costs, so that they will be borne by U.S. taxpayers directly rather than on the users of the canal?

Now, really is not what you are saying that it is your view that if the United States deems it politically expedient to give some \$50 million to \$80 million a year to Panama, it should do so directly, and not take it out of the users of the canal?

Mr. REYNOLDS. I think that is a fair statement that you are making, Mr. Tannenbaum. I think that is, in its bluntest terms, the philosophy of most of the ship operating industry. They think that the negotiation of the treaties is a masterful historic accomplishment, to the credit of the diplomacy of the United States in terms of better relationships with the world community, particularly the South American community, to avoid charges of colonialism, and all of these sensitive things which bear upon the image of the United States around the world, but they should not have to pay for it.

To put it in real blunt terms, they feel it is the cost of a great diplomatic accomplishment, and should not be borne by commercial interests. That is putting it in its plainest terms.

If it is criticism, I think it is well taken, and I respect your right to say it, indeed.

MR. TANNENBAUM. One more brief comment. On page 4 of Mr. Brandes' statement, and in response to some questions I asked him, he indicated, if I understood his responses correctly, that American export commodities will not be affected at all by any toll increases, or very, very slightly, and we would not lose any export business for these commodities.

Your views obviously contradict this, and perhaps before Mr. Brandes completes his statement, and his study, you were to contact him and give him your views.

MR. REYNOLDS. Yes, I am seeing him tomorrow morning at the State Department, Mr. Tannenbaum. I think I am speaking basically of bulk commodities, such as grain, and such as coal. If metallurgical coal from the eastern part of the United States, which is the most superior metallurgical coal in this Nation, can be laid down in Japan for their steel mills, by way of the Panama Canal, at a competitive price, we are going to sell it.

MR. TANNENBAUM. These are the items I am referring to, coal, soybeans, et cetera.

MR. REYNOLDS. I will discuss this with them. Possibly he can correct my statement. I think competition with Australia, is such that we will be priced out of the market, if the cost of delivering them is much higher, and the same is true of much of the grain going in that direction. No question about that.

MR. TANNENBAUM. Thank you very much.

MR. METCALFE. Before dismissing this panel, we thank this panel and the other witnesses, as well as the witness, Mr. Whitman, who will follow this panel, for the hard work they have put in to getting this data together for these hearings. Our appreciation to this panel and all the other panelists.

Thank you very much, gentlemen, for your patience and courtesy.

MR. REYNOLDS. Thank you, Mr. Chairman.

MR. METCALFE. Our final witness will be a consultant to the full Committee on Merchant Marine and Fisheries for Panama Canal matters, Mr. Merrill Whitman.

Mr. Whitman has a long and distinguished background in Panama Canal matters. He was a legal adviser to the Panama Canal Co. for many years, and was also secretary of the Panama Canal Co. for 20 years.

Mr. Whitman has prepared a paper relating to the payments to Panama in article III and article XIII to the Panama Canal treaty and the appropriation process. The constitutional question he will discuss, is whether the payment provisions of the treaty are self-executing, or whether some form of appropriation enactment by Congress must precede the payment of these moneys, regardless of the agency form which the commission might take.

Mr. Whitman.

#### STATEMENT OF W. MERRILL WHITMAN, CONSTITUTIONAL LAWYER, FORMER SECRETARY, PANAMA CANAL CO.

MR. WHITMAN. Thank you, Mr. Chairman.

As you suggest, I have just concluded a rather detailed study of the constitutional considerations involved in the various provisions of the



treaty with Panama, including the provisions of the treaty for annual payments to Panama by the Government agency to be established to operate the canal, to be called the Panama Canal Commission.

My conclusion on the latter point is that under the Constitution, payments to Panama stipulated by the treaty, can be made only pursuant to appropriations by the Congress. The basis for that conclusion is discussed at length in a long memorandum dated November 1977, which I will not undertake to either read or summarize at this point. I will submit it for the record.

[The following was received for the record.]

PANAMA CANAL TREATY PAYMENTS AND THE CONSTITUTIONAL POWER OF  
CONGRESS TO MAKE APPROPRIATIONS

I. INTRODUCTION

*A. Question presented*

The question addressed in this memorandum is whether under Article I, section 9 of the Constitution, appropriations by the Congress are necessary to carry into effect the provisions of the proposed Panama Canal treaty for annual payments to Panama.

*B. Summary*

In summary, the memorandum concludes that under Article I, section 9 of the Constitution, provisions of a treaty for payment of money do not become effective as domestic law in the absence of appropriation of the necessary funds by the Congress. Under the treaties with Panama now in effect, which also provide for annual payments to Panama, revenues derived from operation of the canal are treated as public moneys and expenditures of those funds are limited to those authorized by appropriation acts of the Congress. There is nothing in the language of the proposed treaty to take the annual payments to Panama provided by the treaty out of the operation of the general rule or to distinguish such payments from those provided by the existing treaties so far as concerns the application of Article I, section 9 of the Constitution. Accordingly, such payments may not be made without Congressional appropriations in the consideration of which, in the language of a resolution adopted by the House of Representatives in 1795, the Congress has the obligation to act as, in their judgment, may be most conducive to the public good.

II. CONSTITUTIONAL PROVISIONS

The three constitutional provisions directly involved are Article I, section 9, clause 7, the power to make appropriations; Article II, section 2, clause 2, the treaty power; and Article VI, clause 2, the supremacy. The text of these several clauses is set out below:

*Art. I, sec. 9 cl. 7:* "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; . . ."

*Art. II, sec. 2, cl. 2:* "He [the President] shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; \* \* \*"

*Art. VI., cl. 2:* "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the land; \* \* \*"

It is settled that the power of the President, with the advice and consent of the Senate, to make treaties with foreign countries extends to all proper subjects of negotiation between the United States and other countries.<sup>1</sup> It is also clear that such treaties may extend to subjects that are also within the legislative power of the Congress, i.e., a treaty is not necessarily invalid because it deals with a subject on which Congress has the power to legislate.<sup>2</sup> A treaty

<sup>1</sup> *Asakura v. City of Seattle*, 265 U.S. 332 (1924); See American Law Institute, *Restatement, Second, Foreign Relations Law of the United States*, (1954) §§ 117, 118.

<sup>2</sup> *United States v. The Schooner Peggy*, 1 Cranch 103 (1801); *Hiso v. United States*, 194 U.S. 315 (1904); *Cook v. United States*, 288 U.S. 102 (1933); *Bacardi v. Domenech*, 311 U.S. 150 (1940).

does not affect the power of the Congress to enact legislation on the same subject. In the event of a conflict between the treaty and the law, the later in time prevails.<sup>3</sup>

Once made, a treaty operates in a dual role: in its international aspect, it is a contract between the United States and the country with which it is made giving rise to rights and obligations under international law;<sup>4</sup> and under the supremacy clause of the constitution, a treaty takes effect as domestic law unless, in terms, it is made dependent on further legislative action by the Congress,<sup>5</sup> or unless the provisions of the treaty are in conflict with other provisions of the constitution.<sup>6</sup>

Analysis of the effect of a treaty as domestic law is usually cast in terms of whether or not the treaty is self-executing, i.e., whether it takes effect as domestic law without further action by the Congress. The state of the law in this respect is summarized as follows by the American Law Institute:<sup>7</sup>

"(1) A treaty made on behalf of the United States in conformity with the constitutional limitations indicated in § 118, that manifests an intention that it shall become effective as domestic law of the United States at the time it becomes binding on the United States.

"(a) is self-executing in that it is effective as domestic law of the United States

"(b) supersedes inconsistent provisions of earlier acts of Congress or of the law of the several states of the United States

\* \* \* \* \*

"(3) A treaty cannot be self-executing under the rule stated in subsection (1) and have the effect stated therein to the extent that it involves governmental action that under the Constitution can be taken only by Congress."

The provisions of the proposed Panama Canal treaty for annual payments to Panama by the U.S. Government agency to be established to operate the canal, raise directly the question whether such provisions are self-executing in view of Article I, sec. 9, cl. 7 of the constitution limiting to the Congress the power to make appropriations.

There appears to be no controversy whatever as to the constitutional validity of treaty provisions under which the United States undertakes to make payments of money.<sup>8</sup> The first treaty made by the Government of the United States after the adoption of the constitution, the Jay Treaty of 1794 with Great Britain, provided for payment of debts owed by U.S. citizens or inhabitants to British creditors;<sup>9</sup> the treaties with France for the cession of Louisiana provided for payment to France of 60 million francs;<sup>10</sup> the Treaty of Paris, ending the Spanish-American War, provided for the payment of \$20 million to Spain for the Philippine Islands;<sup>11</sup> the 1903 convention with Panama providing for construction and maintenance of the Panama Canal, provided for a lump sum payment to Panama of \$10 million and annual payments of \$250,000.<sup>12</sup> These examples could be duplicated many times over and in no instance has such a treaty provision been challenged as beyond the constitutional power of the President.<sup>13</sup>

If, as appears to be the case, Article I, sec. 9, cl. 7 of the constitution does not preclude the negotiation of a treaty providing for the payment of money by the United States, the conclusion is otherwise in respect to attempts to set up a procedure for transfer of funds in discharge of the treaty commitment without an appropriation by Congress.

After the ratification of the Jay treaty, the effect of the provisions of the

<sup>3</sup> *The Cherokee Tobacco*, 11 Wall. 616 (1870); *Head Money Cases*, 112 U.S. 580, 598 (1884); *Taylor v. Morton*, 23 Fed. Cas. 784 (CC Mass., 1885).

<sup>4</sup> *Foster v. Neilsen*, 2 Pet. 253 (1829); *Head Money Cases*, 112 U.S. 580 (1884).

<sup>5</sup> An example is Item I of the Memorandum of Understandings Reached attached to the 1955 Treaty with Panama for which the United States agreed that "Legislation will be sought" to authorize the U.S. Government agencies in the Canal Zone to conform their employment practices to certain stated principles.

<sup>6</sup> *Reid v. Covert*, 346 U.S. 1, at 17 (1957); *The Cherokee Tobacco*, 11 Wall. 616, 620 (1870).

<sup>7</sup> *Restatement, Second, Foreign Relations Law of the United States*, (1951) § 141.

<sup>8</sup> See XIII Op. Atty. Gen. 354 (1870).

<sup>9</sup> 8 Stat. 116.

<sup>10</sup> Malloy, *Treaties, Conventions, International Acts, Protocols and Agreements Between the United States of America and Other Powers*, Vol. 1, p. 511.

<sup>11</sup> 30 Stat. 1756.

<sup>12</sup> 33 Stat. 2234.

<sup>13</sup> See Crandall, *Treaties, Their Making and Enforcement*, 1966, pp. 178-182.



treaty requiring expenditure of funds was debated at length in the House of Representatives. The debate did not involve the question whether the President could enter into a treaty requiring the expenditure of funds; the two questions at issue were (1) whether the House of Representatives was entitled to obtain copies of instructions given by the President to the negotiators, and (2) whether the Congress was required to appropriate the funds necessary to carry the treaty into effect, in view of the provision of Art. VI, clause 2 of the constitution declaring that treaties along with the constitution and laws made in pursuance thereof shall be the supreme law of the land.<sup>14</sup> President Washington rejected the demand of the House for copies of the instructions to the negotiators,<sup>15</sup> but the House adopted a resolution introduced by Thomas Blount, vigorously supported by James Madison, providing as follows:

"When a treaty stipulates regulations on any of the subjects submitted by the Constitution to the power of Congress, it must depend for its execution, as to such stipulations, on a law or laws to be passed by Congress. And it is the Constitutional right and duty of the House of Representatives, in all such cases, to deliberate on the expediency or in expediency of carrying such treaty into effect, and to determine and act thereon, as, in their judgment, may be most conducive to the public good."<sup>16</sup>

Congress thereafter enacted a law making the necessary appropriations.<sup>17</sup>

When difficulties arose in the execution of Art. VI of the Jay treaty, providing for payment by the United States of certain debts owing by U.S. debtors to British creditors, a second convention was negotiated and ratified providing for discharging the responsibility of the United States under Art. VI by payment of 600,000 pounds sterling in three equal annual installments.<sup>18</sup> On April 27, 1802, President Jefferson sent copies of the convention to the Congress with a brief message concluding as follows:

"I now transmit copies thereof to both Houses of Congress, trusting that, in the free exercise of the authority which the Constitution has given them on the subject of public expenditures they will deem it for the public interest to appropriate the sums necessary for carrying this convention into execution."<sup>19</sup>

The same principles were recognized and the same procedure was followed in reference to the three treaties with France for cession of Louisiana to the United States. In Article I of the second of the three treaties, the United States agreed "to pay to the French Government, in the manner specified in the following article, the sum of sixty millions of francs. . . ." Article II specified that payment to France would be effected by issuance of stock of \$11,250,000 bearing interest at the rate of 6%, with a further provision for retirement of the principal in annual payments of \$3 million, commencing 15 years after the date of the exchange of ratifications.<sup>20</sup> In his message to Congress on October 17, 1803, President Jefferson referred to the treaties with the statement that after ratification "they will without delay, be communicated to the Representatives for the exercise of their functions as to those conditions which are within the powers vested by the Constitution in the Congress."<sup>21</sup>

On October 21, 1803, the date of the ratification of the treaties, the President forwarded copies to the Senate and House of Representatives with a message which, after referring to his earlier message of October 17, in reference to the treaties, concluded:

"These, with the advice and consent of the Senate having now been ratified, . . . they are communicated to you for consideration in your legislative capacity. You will observe that some important conditions cannot be carried into execution, but with the aid of the Legislature, and that time presses a decision on them without delay."<sup>22</sup>

Adherence to the view that provisions of treaties for the payment of money by the United States are not self-executing, but that Congress is required to

<sup>14</sup> 5 Annals of Congress, 4th Cong., 1st Sess., pp. 426-783.

<sup>15</sup> *Id.*, pp. 759-762.

<sup>16</sup> *Id.*, pp. 771-782.

<sup>17</sup> 1 Stat. 459.

<sup>18</sup> Convention for Payment of Indemnities and Settlement of Debts, concluded Jan. 8, 1802; ratified Apr. 27, 1802, proclaimed Apr. 27, 1802. The text of the Convention appears in Malloy, *Treaties, etc.*, vol. 1, p. 610.

<sup>19</sup> Debates and Proceedings, Seventh Cong., pp. 293, 294.

<sup>20</sup> For the full text of the treaties see Malloy, *Treaties, etc.*, vol. 1, p. 513.

<sup>21</sup> Annals, 8th Cong., p. 11.

<sup>22</sup> *Id.*, pp. 17, 18.

exercise independent judgment in considering appropriations for such payments, has not been confined to the House of Representatives.

During the debates in the Senate on entry by the United States into the League of Nations and related treaties negotiated at the end of World War I, a resolution was introduced to request the Judiciary Committee to advise the Senate as to whether there was any constitutional objection to one of the treaties providing for military assistance to France. In the course of a comprehensive review and analysis of the treaty making power, Senator Kellogg (who was later to become Secretary of State) referred to the exclusive power of the Congress to make appropriations as follows:

"\* \* \* it is well settled that while the treaty-making power can obligate the United States to the payment of the sums of money, it can not itself appropriate from the United States Treasury the amounts specified or compel the Congress to provide for their payment \* \* \* Undoubtedly nations dealing with the treaty-making power are presumed to have knowledge of this limitation."<sup>23</sup>

The relationship of the supremacy clause and the constitutional power of Congress to make appropriations was considered in the federal circuit court at an early date in a case involving the effect of an 1836 treaty with an Indian tribe, which among other things, provided for payment of the net proceeds of the sale of 160 acres of land to the owner of the buildings on the land. In that case the court said:

"A treaty under the Federal Constitution is declared to be the Supreme law of the land. This, unquestionably, applies to all treaties, where the treaty-making power, without the aid of Congress, can carry it into effect. It is not, however, and cannot be the Supreme law of the land, where the concurrence of Congress is necessary to give it effect. Until this power is exercised, as where the appropriation of money is required, the treaty is not perfect. It is not operative, in the sense of the Constitution, as money cannot be appropriated by the treaty making power. This results from the limitations of our government. \* \* \* As well might it be contended that an ordinary act of Congress, without the signature of the President, was a law, as that a treaty which engages to pay money, is in itself a law. \* \* \* It [the treaty-making power] cannot bind or control the legislative action in this respect, and every foreign government may be presumed to know that as far as the treaty stipulates to pay money, the legislative action is required."<sup>24</sup> [Emphasis supplied.]

The view that a treaty provision for the payment of money is not self-executing but requires an appropriation by the Congress is also reflected in the American Law Institute comment on section 141 of its restatement of foreign relations law, quoted above, which states:

"f. *Constitutional limitation on self-executing treaties.* Even though a treaty is cast in the form of a self-executing treaty, it does not become effective as domestic law in the United States upon becoming binding between the United States and the other party or parties, if it deals with a subject matter that by the Constitution is reserved exclusively to Congress. For example, only the Congress can appropriate money from the Treasury of the United States."

\* \* \* \* \*

"*Illustration:* 8. The United States enters into a treaty with State A under which A agrees to cede a portion of its territory to the United States in return for payment of \$7,200,000. Advice and consent to the ratification of the treaty is given by the Senate and it is ratified by the President. The ratification does not have the effect of appropriating the \$7,200,000. Further action to this effect must be taken by both Houses of Congress."<sup>25</sup>

This view of the effect of Article I, section 9 has not been disputed by the Department of State in the hearings on the Panama Canal treaties signed in September 1977. In hearings on the treaties before a subcommittee of the Senate Judiciary Committee, the Legal Adviser of the Department of State conceded that Article 1, sec. 9, cl. 7 of the constitution constitutes a limitation on the treaty power so that "treaties may neither impose taxes nor directly appropriate funds."<sup>26</sup>

<sup>23</sup> 58 Cong. Rec., Pt. 4, p. 3680 at 3687.

<sup>24</sup> *Turner v. American Baptist Missionary Union*, Fed. Cas. No. 14251, CC Mich. (1852), 24 Fed. Cas. 345, 346.

<sup>25</sup> *Restatement, Second. Foreign Relations Law of the United States* (1965), p. 435.

<sup>26</sup> Hearings, Subcommittee on Separation of Powers, Committee on the Judiciary, United States Senate, 95th Cong., 1st sess., *Panama Canal Treaty*, Part 2, p. 4.



Similarly, at hearings on the treaty on September 29, 1977, Attorney General Griffin Bell advised the Senate Foreign Relations Committee that:

"It is generally assumed that the specific powers granted to the House of Representatives and the Congress in fiscal matters (Article I, section 7, clause 1 and Article I, section 9, clause 7, money bills and appropriation power) preclude making treaties self-executing to the extent that they involve the raising of revenue or the expenditure of funds. Were it otherwise, President and Senate could bypass the power of Congress and in particular of the House of Representatives over the pursestrings."

In the light of the constitutional principles summarized above, it appears that the provisions of the proposed Panama Canal treaty for payments to Panama are not self-executing but require legislative action by the Congress unless there is some special element involved in the treaty provisions or in the nature of the canal operation that would serve to take the payments to Panama out of the operation of the constitutional rules that would otherwise apply. Review of the pertinent treaty provisions and of the legal and fiscal characteristics of the operation of the canal, either at present or under the proposed treaties, discloses no such distinguishing characteristics.

### III. PANAMA CANAL TREATIES AND OPERATING STRUCTURE

#### *A. 1903 Treaty*

In 1902 an act of Congress, popularly known as the Spooner Act, authorized the President to acquire control of the land and other rights necessary for the construction and operation of a transisthmian canal and to proceed with the construction of such a canal when such rights were obtained.<sup>27</sup> After an abortive effort to obtain the necessary rights in a treaty with Colombia, and following secession of Panama from the Republic of Colombia, the United States on November 18, 1903, entered into a treaty with the Republic of Panama providing for the acquisition by the United States of the rights specified in the Spooner Act and for the construction and operation by the United States of a transisthmian canal at Panama. Article XIV provides that:

"As the price or compensation for the rights, powers, and privileges granted in this convention by the Republic of Panama to the United States, the Government of the United States agrees to pay to the Republic of Panama the sum of ten million dollars (\$10,000,000) in gold coin of the United States on the exchange of the ratification of this convention and also an annual payment during the life of this convention of two hundred and fifty thousand dollars (\$250,000) in like gold coin, beginning nine years after the date aforesaid. \* \* \*

#### *B. 1936 Treaty*

A treaty between the United States and the Republic of Panama signed March 2, 1936,<sup>28</sup> among other provisions, abrogated certain provisions of the 1903 treaty, and placed restrictions on residence, importations, and commercial activity in the Canal Zone.<sup>29</sup> Article VII of the 1936 treaty increased the amount of the annuity payable to the Republic of Panama under Article XIV of the 1903 treaty to four hundred thirty thousand Balboas (B/430,000) as defined in a separate monetary agreement, effected by an exchange of notes on the same date as the treaty. The treaty authorized payment of the annuity in any coin or currency provided the amount so paid was the equivalent of B/430,000 as defined in the monetary agreement.

#### *C. 1955 Treaty*

A third treaty between the United States and the Republic of Panama, signed January 25, 1955,<sup>30</sup> contained among other provisions, an article that increased the annuity to one million nine hundred thirty thousand Balboas (B/1,930,000) as defined by the agreement embodied in the exchange of notes of March 2, 1936, but authorized the United States to discharge its obligation with respect to payment of the annuity in any coin or currency provided the amount so paid is the equivalent of one million nine hundred thirty thousand balboas (B/1,930,000) as so defined.<sup>31</sup>

<sup>27</sup> 32 Stat. 481.

<sup>28</sup> 53 Stat. 1807.

<sup>29</sup> Article III; see C. Z. Code, appendix IX, § 34.

<sup>30</sup> TIAS 3297.

<sup>31</sup> Article I.

### *D. Panama Canal Organizational Structure*

Construction of the Panama Canal was accomplished by the Isthmian Canal Commission under the provisions of the Spooner Act, *supra*. As construction approached completion, Congress passed the Panama Canal Act of August 24, 1912,<sup>32</sup> providing for the opening, maintenance, protection, and operation of the Panama Canal and the sanitation and government of the Canal Zone. The Act authorized the President to discontinue the Isthmian Canal Commission and to complete, govern and operate the Panama Canal through a Governor of the Panama Canal. The pertinent provisions of the Panama Canal Act were later incorporated in the Canal Zone Code, enacted in 1934.<sup>33</sup>

The adjuncts of the Panama Canal, referred to in the Panama Canal Act, were principally consolidated in the operations of the Panama Railroad Company, originally created in 1849 under the laws of the State of New York as a private corporation for the construction and operation of a railroad across the Isthmus of Panama. At the time of the construction of the Panama Canal all the stock of the Company was acquired by the United States and, after the canal was completed, the railroad conducted certain business operations supporting the maintenance and operation of the canal, including operation of a transisthmian railroad, a steamship line operating between the United States and the Canal Zone, docks, harbor terminals, coaling plants for bunkering ships, commissaries for supplying employees and ships, dry and cold storage plants, hotels, and the telephone system of the Canal Zone. The Supreme Court has characterized these operations as auxiliaries primarily designed and used to aid in the canal's management and operation,<sup>34</sup> and they have been similarly described by the Congressional Committees responsible for Panama Canal affairs.<sup>35</sup>

In 1945, the Government Corporation Control Act<sup>36</sup> designated the Panama Railroad Company as a wholly-owned government corporation and prohibited the existence of any such wholly-owned government corporations created under the laws of a state. Accordingly, in 1948, the Panama Railroad Company was reincorporated under a federal charter with authority to continue its operation in support of the maintenance and operation of the Panama Canal.<sup>37</sup>

Under legislation enacted in 1950, a basic change in the organizational structure of the enterprise became effective July 1, 1951.<sup>38</sup> One purpose of the reorganization was to separate the business operations of the canal enterprise, including operation of the waterway, from those functions associated with civil government of the Canal Zone. All the functions of the agency previously known as The Panama Canal, except those relating to civil government, health and sanitation were transferred to the Panama Railroad Company which was renamed the Panama Canal Company. The Panama Canal agency retained its governmental functions and was renamed the Canal Zone Government. A second purpose of the reorganization was to give the Panama Canal Company authority to prescribe the rates of tolls for use of the canal, subject to final approval by the President.<sup>39</sup> Previously, power to prescribe rates of tolls had been vested exclusively in the President since the enactment of the Panama Canal Act in 1912.<sup>40</sup>

The basic provisions of the 1950 reorganization legislation were subsequently incorporated into the 1962 edition of the Canal Zone Code.<sup>41</sup> Under the statutory scheme, the Panama Canal Company and the Canal Zone Government function as an integrated enterprise although each is an independent agency of the United States.<sup>42</sup>

The Panama Canal Company is described in the law as a body corporate and an agency of the United States for the purpose of maintaining and operating the Panama Canal and conducting business operations incident thereto and incident to the civil government of the Canal Zone.<sup>43</sup>

<sup>32</sup> 37 Stat. 560.

<sup>33</sup> 48 Stat. 1122.

<sup>34</sup> *New York ex rel. v. Rogers v. Graves*, 299 U.S. 401, 406 (1937).

<sup>35</sup> H. Rept. No. 2396, 80th Cong., pp. 1-2; S. Rept. No. 1401, 80th Cong., pp. 1-2.

<sup>36</sup> 31 U.S.C. 841 et seq., 59 Stat. 597.

<sup>37</sup> 62 Stat. 1076.

<sup>38</sup> Act of Sept. 26, 1950, 64 Stat. 1038.

<sup>39</sup> See H. Rept. 2935, 81st Cong., and H. Doc. 400, 81st Cong., for analysis of the objectives of the Act of Sept. 26, 1950.

<sup>40</sup> See Panama Canal Act of Aug. 14, 1912, 37 Stat. 560, and 2 C.Z. Code (1934 ed.) § 411.

<sup>41</sup> 76A Stat. 1, et seq.

<sup>42</sup> See 2 C.Z. Code § 62(g).

<sup>43</sup> 2 C.Z. Code §§ 61-75, 121-123.



The powers of the Company are enumerated in its charter.<sup>44</sup> In general, the principal activities of the Company are (1) operations directly involved in the movement of ships through the canal and (2) supporting services. The latter include vessel repairs, harbor terminals, a railroad across the Isthmus, a supply ship operating between the United States and the Canal Zone, motor transportation facilities, storehouses, an electric power system, a communications system, a water system, and service activities essential for meeting the needs of employees, such as living quarters, commissaries and restaurants.

Under its charter the Company is required to be self-sustaining although appropriations are authorized to cover any operating losses,<sup>45</sup> or for capital improvements.<sup>46</sup> Appropriations for operating losses are required to be repaid.

The Company is also required to reimburse the Treasury for interest on the net direct investment of the United States in the corporation at rates fixed annually by the Secretary of the Treasury,<sup>47</sup> for the annuity paid under the 1903 treaty as amended by the 1936 treaty, and for the net cost of operation of the agency known as the Canal Zone Government.<sup>48</sup>

The Board of Directors of the Company is required to review annually its working capital requirements together with foreseeable requirements for plant replacements and expansion and to pay any amounts in excess thereof into the Treasury.<sup>49</sup> Since 1950 the Company has paid \$40 million into the Treasury for this purpose.

#### IV. FISCAL MANAGEMENT OF GOVERNMENT AGENCIES

Article III of the proposed Panama Canal treaty specifies that the U.S. Government agency to be established to operate the canal "shall be constituted by and in conformity with the laws of the United States." The laws of the United States governing the fiscal management of government agencies in general are incorporated in Title 31 of the U.S. Code.<sup>50</sup>

The Executive Departments and non-corporate federal agencies are subject generally to the provisions of title 31, except the provisions of the Government Corporation Control Act. Wholly owned government corporations are subject to the provisions of the Government Corporation Control Act and to many of the other provisions of title 31 as well.

The provisions of title 31 clearly delineate the fiscal responsibilities of government agencies generally and their dependence on appropriations to authorize the expenditure of funds. The Budget and Accounting Act, 1921, defines "department or establishment" to include "any executive department, independent commission, board, bureau, office, agency or other establishment of the Government," and the term "appropriations" to include funds and authorizations to create obligations by contract in advance of appropriations or "any other authority making funds available for obligation or expenditure."<sup>51</sup> All moneys received from whatever source for use of the United States are required to be paid into the Treasury.<sup>52</sup> Detailed provisions are made for submission of estimates for appropriations for expenditure by government agencies.<sup>53</sup> Expenditures in excess of appropriations are prohibited, and all appropriations or funds made available for obligation are required to be apportioned to avoid the necessity for deficiency or supplemental appropriations.<sup>54</sup>

Agencies of the government in corporate form, such as the agency now responsible for operation of the Panama Canal, are established pursuant to and operate in accordance with the Government Corporation Control Act, and other applicable provisions of title 31 of the U.S. Code. The Government Corporation Control

<sup>44</sup> 2 C.Z. Code §§ 65-66.

<sup>45</sup> 2 C.Z. Code § 72.

<sup>46</sup> 2 C.Z. Code § 62.

<sup>47</sup> 2 C.Z. Code § 62(e).

<sup>48</sup> 2 C.Z. Code § 62(g).

<sup>49</sup> 2 C.Z. Code § 70.

<sup>50</sup> Pertinent provisions of title 31 include the following:

1. The Budget and Accounting Act of 1921 (31 U.S.C. §§ 1-64, 71, 471, 581, 581a).  
2. Budget and Accounting Procedures Act of 1950 (31 U.S.C. §§ 2, 11, 14, 16, 18a-18c, 22-24, 65-67, 581-581c, 847).

3. Chapter 10, §§ 471-564, headed "The Public Moneys."

4. Chapter 11, §§ 581-752Z, headed "Appropriations."

5. The Government Corporation Control Act, §§ 841-871.

6. Chapter 22, §§ 1151-1176, headed "Fiscal Controls."

<sup>51</sup> 31 U.S.C. 2.

<sup>52</sup> 31 U.S.C. 484.

<sup>53</sup> 31 U.S.C. 581-752Z.

<sup>54</sup> 31 U.S.C. 665.

Act requires a government agency subject to the Act to submit annually to the Congress, through the Office of Management and Budget and the President, a budget program which among other things must include a statement of financial condition and of income and expense, a statement of sources and application of funds, and such other supplementary statements and information as are necessary or desirable to make known the financial condition and operation of the corporation.<sup>55</sup> The Congress, after consideration of the budget program, is required to enact legislation "making necessary appropriations, as may be authorized by law, making available for expenditure for operating and administrative expenses such corporate funds or other financial resources, or limiting the use thereof as the Congress may determine and providing for repayment of capital funds and the payment of dividends."<sup>56</sup> The legislation making funds available for payment of expenses of the corporation is regularly incorporated in the annual appropriation acts enacted by the Congress.<sup>57</sup> Accounts of corporations are required to be kept with the Treasury, or with the approval of the Secretary of the Treasury, with a Federal Reserve Bank or a bank designated as a depository or fiscal agent of the United States.<sup>58</sup> Agencies in corporate as well as non-corporate form are subject to the provisions of the anti-deficiency act requiring apportionment of all appropriations or funds made available for obligation.<sup>59</sup>

#### V. PANAMA CANAL FUNDS AND PAYMENTS TO PANAMA UNDER PRESENT TREATIES

##### A. Panama Canal Funds

The basic framework for operation of the Panama Canal under the 1903 treaty was provided by section 5 of the Panama Canal Act referred to in Part III of this memorandum. Under that Act, the President was authorized to prescribe "tolls that shall be levied by the Government of the United States for the use of the Panama Canal" which were required to be fixed at rates sufficient to pay the estimated cost of the actual maintenance and operation of the canal.<sup>60</sup> Under the general laws of the United States applicable to the handling of funds of government agencies, tolls and other revenues were paid into the Treasury as miscellaneous receipts, and all disbursements were covered by direct appropriations.<sup>61</sup> Exceptions to the general rule, permitting expenditure of canal revenues before being covered into the Treasury were covered by appropriations made by the Congress.

Thus, section 6 of the Panama Canal Act authorized the President, through the Panama Railroad Company or otherwise, to operate dry docks, repair shops, yards, docks, wharves, warehouses, storehouses and other necessary facilities and appurtenances, "in accordance with appropriations hereby authorized to be made from time to time by Congress as part of the maintenance and operation of the Panama Canal. Moneys received from the conduct of said business may be expended and reinvested for such purposes without being covered into the Treasury of the United States, and such moneys are hereby appropriated for such purposes, but all deposits of such funds shall be subject to the provisions of existing law relating to the deposit of other public funds of the United States, and any net profit accruing from such business shall annually be covered into the Treasury of the United States."<sup>62</sup>

Similar provisions were included in the Sundry Civil Appropriations Act, 1917, which also "appropriated out of any money hereafter received as tolls, before such money is covered into the Treasury as miscellaneous receipts" amounts necessary to make refunds of tolls that were erroneously collected.<sup>63</sup>

<sup>55</sup> 31 U.S.C. § 47, 848.

<sup>56</sup> 31 U.S.C. § 849.

<sup>57</sup> See, for example, Public Law 95-85, Department of Transportation and Related Agencies Appropriation Act, 1978, approved Aug. 2, 1977.

<sup>58</sup> 31 U.S.C. § 867.

<sup>59</sup> 31 U.S.C. § 665.

<sup>60</sup> 37 Stat. § 562.

<sup>61</sup> *Annual Report of the Governor of the Panama Canal, Fiscal year 1915*, pp. 10 et seq., 41-47, 297, 298, 300.

<sup>62</sup> 37 Stat. § 563. These provisions were reenacted as Chapter 4 of Title 2 of the Canal Zone Code (1934 ed.) comprising sections 51 and 52. In 1947, Chapter 4 was expanded into four sections, 51-54, retaining the provisions for appropriations and covering net profits into the Treasury. 63 Stat. § 601. The sections were repealed by the Act of Sept. 26, 1950, 64 Stat. § 1049, when the canal and related supporting facilities were transferred to the Panama Canal Company for operation under the provisions of the Government Corporation Control Act.

<sup>63</sup> Act of June 12, 1917, 40 Stat. § 179.



After the Act of September 26, 1950, the agency previously known as The Panama Canal and renamed Canal Zone Government, continued to pay all revenues into the Treasury and receive direct appropriations to cover expenses of performance of its various duties in reference to the civil government of the Canal Zone.<sup>64</sup>

In the operation of the canal and related facilities, the Panama Canal Company is subject to the provisions of the Government Corporation Control Act.<sup>65</sup> As noted above, under that Act, funds of the Company, which must be deposited into accounts with the Treasury or depository banks approved by the Secretary of the Treasury,<sup>66</sup> are made available for expenditure by appropriations enacted annually by the Congress, after consideration of a detailed budget program submitted to Congress by the President in the Annual Budget of the United States.<sup>67</sup>

### *B. Payments to Panama*

Funds for the lump sum payment to Panama of \$10 million provided for in Article XIV of the 1903 treaty were appropriated by Congress by the Act of April 28, 1904.<sup>68</sup> An appropriation of \$250,000 to enable the Secretary of State to make the first annual payment to Panama, due February 28, 1913, was made in a deficiency appropriation act for that year.<sup>69</sup> Funds for the annual payments to Panama under the applicable treaties were thereafter regularly included in appropriation acts for the Department of State until a permanent appropriation was enacted for making the annual payments in the amounts specified by the 1903 and 1936 treaties (\$430,000).<sup>70</sup> In 1955 the appropriation was increased to \$1,930,000 to cover the corresponding increase in the payments provided by Article I of the 1955 treaty,<sup>71</sup> and subsequent appropriation acts have adjusted the amount of the annual payment to reflect the effect of the relationship of the dollar to the price of gold.<sup>72</sup> The current amount of the annual payment (\$2,328,000) is shown as one of three permanent appropriations in the Department of State budget for fiscal year 1978.<sup>73</sup>

When Congress provided in 1950 for operation of the canal by the government corporation previously known as the Panama Railroad Company and renamed the Panama Canal Company, the corporation was required to reimburse the Treasury for the amount of the annual payments to Panama under Article XIV of the 1903 treaty as modified by Article VII of the 1936 treaty, then totaling \$430,000 a year.<sup>74</sup> When the 1955 treaty increased the amount of the annuity payment to Panama to \$1,930,000, a Senate amendment of the bill to implement the treaty that would have required the corporation to reimburse the Treasury for the amount of the increase was deleted in conference.<sup>75</sup> The amount of the annual payment to Panama reimbursed to the Treasury is one of the costs of operation of the canal recovered from user charges under the tolls formula enacted by Congress,<sup>76</sup> but the payment by the corporation is to the Treasury, not to Panama, and the total amount of the annual payment to Panama is covered by appropriations budgeted by the Department of State.

<sup>64</sup> See *Annual Report, Canal Zone Government, Fiscal Year 1976*, p. 135; the functions of the Canal Zone Government in relation to the operation of the canal under the 1950 legislation are summarized in Part III of this memorandum.

<sup>65</sup> 31 U.S.C. 846; 2 C.Z. Code 66; Act June 29, 1948 (62 Stat. 1076).

<sup>66</sup> 31 U.S.C. 867. The provisions of the Government Corporation Control Act are summarized in Part IV of this memorandum.

<sup>67</sup> See, for example, Department of Transportation and Related Agencies Appropriation Act, 1978, 91 Stat. 402 at 414.

<sup>68</sup> 33 Stat. 420.

<sup>69</sup> Act Mar. 4, 1913, 37 Stat. 913.

<sup>70</sup> Department of State Appropriation Act, 1954, 67 Stat. 368. See S. Docs. S3d Cong., 1st sess., vol. 7, p. 180.

<sup>71</sup> Supplemental Appropriation Act, 1956, 69 Stat. 464.

<sup>72</sup> The "permanent" appropriation for annual payments to Panama was increased to \$2,095,405 by the Supplemental Appropriation Act, 1973, 86 Stat. 1498; and to \$2,328,000 by the Department of State Appropriation Act, 1974, 87 Stat. 640.

<sup>73</sup> Hearings, Subcommittee of Committee on Appropriations, House of Representatives, 95th Cong., 1st sess., *Department of State, Justice, Commerce Judiciary, and Related Agencies Appropriation Act for 1978*, Part 2, p. 40.

<sup>74</sup> Act Sept. 26, 1950, § 7, 64 Stat. 1041; 2 C.Z. Code 62(g). The dollar amount reimbursed to the Treasury adjusted for devaluation of the dollar is currently \$519,000. Hearings, Subcommittee of Committee on Appropriations, House of Representatives, 95th Cong., 1st sess., *Department of Transportation and Related Agencies Appropriations for 1978*, Part 1, p. 686.

<sup>75</sup> H. Rept. No. 1196, 85th Cong., 1st sess., to accompany H.R. 6709.

<sup>76</sup> Act Sept. 26, 1950, § 12, 64 Stat. 1022; 2 C.Z. Code 412.

## VI. PROPOSED PANAMA CANAL TREATY

*A. Operation of the Panama Canal—The Panama Canal Commission*

Insofar as concerns the question of the compatibility of the provisions of the proposed Panama Canal treaty with the provisions of the constitution limiting to the Congress the power to make appropriations, the pertinent provisions of the proposed treaty include the following:

Article I of the proposed treaty<sup>77</sup> grants to the United States for the duration of the treaty, "the rights necessary to regulate the transit of ships through the Panama Canal, and to manage, operate, maintain, improve, protect and defend the canal."<sup>78</sup>

Under Article III of the treaty:

The United States "may" establish, modify, collect and retain tolls for the use of the Panama Canal, and other charges, and establish and modify methods of their assessment."<sup>79</sup>

The United States "shall, in accordance with the terms of this treaty and the provisions of United States law, carry out its responsibilities by means of a United States Government agency called the Panama Canal Commission, which shall be constituted by and in conformity with the laws of the United States of America."<sup>80</sup>

The Panama Canal Commission is to be supervised by a nine-member Board, the membership of which is to be comprised of five nationals of the United States and four nationals of Panama.<sup>81</sup>

The United States is to employ a national of the United States as Administrator of the Commission and a Panamanian national as Deputy Administrator through December, 1989. After that date the Administrator is to be a Panamanian and the Deputy Administrator a United States national.<sup>82</sup>

On the effective date of the treaty, "the United States Government agencies known as the Panama Canal Company and the Canal Zone Government shall cease to operate within the territory of the Republic of Panama that formerly constituted the Canal Zone."<sup>83</sup>

Other than to specify the name of the agency to be established to operate the canal, and to provide for Panamanian participation in the supervisory Board and appointment of a national of Panama, first as the Deputy Administrator and later as Administrator, the treaty leaves the form of the agency and the description of its powers entirely to the laws of the United States.

The laws of the United States governing the funding and fiscal obligations of government agencies generally are summarized in Part IV of this memorandum, and the application of those laws to the various agencies presently involved in the administration of the Panama Canal is described in Part V.

*B. Payments to Panama*

Article III of the treaty provides that "the Panama Canal Commission shall reimburse the Republic of Panama" in the amount of \$10 million per annum for certain described services in canal operating areas and housing areas presently provided in the Canal Zone by the Panama Canal Company and Canal Zone Government. Provision is made for adjustment of the amount of the payment in three years for inflation and "other relevant factors affecting the cost of such services."<sup>84</sup>

Article XIII of the treaty provides that:

The United States of America transfers, without charge, to the Republic of Panama all right, title, and interest the United States of America may have with respect to all real property, including non-removable improvements in the present Canal Zone, on a time schedule set out in the Article.<sup>85</sup>

<sup>77</sup> Sen. Exec. N, 95th Cong., 1st sess.

<sup>78</sup> Art. 1, sec. 2.

<sup>79</sup> Sec. 2(d).

<sup>80</sup> Sec. 3. An illustrative description of the activities to be performed by the Commission, attached in an Annex, is referred to in section 4 of Article III. The Annex is published in Selected Documents, No. 6B, Department of State Publication 8914, *Documents Associated with the Panama Canal Treaties*, p. 1.

<sup>81</sup> Sec. 3(a).

<sup>82</sup> Sec. 3(c).

<sup>83</sup> Sec. 10.

<sup>84</sup> Sec. 5.

<sup>85</sup> Sec. 2.



The Republic of Panama shall receive "from the Panama Canal Commission" a return on the national resources dedicated to the operation of the canal in the form of three categories of annual payments:<sup>86</sup>

(a) "An annual amount to be paid out of Canal operating revenues" computed at the rate of 30¢ per Panama Canal net ton, or its equivalency, for each vessel transiting the canal after entry into force of the treaty for which tolls are charged;

(b) A fixed annuity of \$10 million to be paid "out of Canal operating revenues" and to "constitute a fixed expense of the Panama Canal Commission."

(c) An additional annual amount of \$10 million "to be paid out of Canal operating revenues" to the extent such revenues exceed expenditures with a provision for carry over of unpaid balances of this payment to future years.

#### *C. Effect of Treaty Provisions for Payment to Panama*

Nothing in the language of the proposed treaty serves to take the stipulated payments to Panama out of the accepted principle that a treaty providing for the payment of money is not self-executing but, under the Constitution, requires appropriations by the Congress. In the 1903 treaty, the United States agreed to pay to Panama a lump sum of \$10 million and annual payments of \$250,000. Appropriations were required and have been obtained for all such payments.

The prescription of the proposed new treaty that the payments to Panama are to be made by the Panama Canal Commission appears to be without significance in this context. The Commission is the agency of the United States that the treaty provides will be "constituted by and in conformity with the laws of the United States of America" by means of which "the United States of America shall, in accordance with the terms of this treaty and the provisions of United States law" carry out its responsibilities under the treaty.<sup>87</sup> The responsibilities are clearly those of the United States as a party to the treaty and as principal of the agency to be established under United States law. Presumably it would not be seriously contended that the effect of the constitutional provision limiting to the Congress the power to make appropriations can be circumvented by the device of providing in the treaty that a payment without appropriations is to be made by a named government agency instead of by the United States.

The purpose of the addition in Article XIII of the treaty of the language that the payments provided in that article are to be made by the Commission "out of canal operating revenues" is not immediately apparent. The "canal operating revenues" referred to are presumably the "tolls for the use of the Panama Canal, and other charges" which the United States (not the Panama Canal Commission) is authorized to "Establish, modify, collect and retain" by Article III, section 2(c) of the treaty. These revenues are the same in kind as those that have been derived by the United States from the Panama Canal since it was opened to commerce and which have been expended pursuant to appropriations by the Congress since that time.

It may be that the objective of the provision of the treaty for making the payments "out of canal operating revenues" was to identify such payments as part of the cost of operation for purposes of establishing rates of tolls. Such a construction necessarily assumes that revenues will be sufficient to cover both the payments to Panama and operating expenses other than such payments and leaves unanswered the obvious question of the results of a disparity between the amount of revenues and the total of such expenses—is such a deficiency to be absorbed by the United States Government by appropriations to cover losses, or by Panama through acceptance of less than the amount of the payments stipulated by the treaty? In either case, the provision for payment out of revenues does not appear to affect the constitutional requirement for appropriations to carry the provisions into effect.

The provision of section 4(c) of Article XIII for payment of \$10 million "out of canal operating revenues to the extent that such revenues exceed expenditures of the Panama Canal Commission" bears some resemblance to the present provision of law requiring the agency operating the canal to pay into the United States Treasury annually in reduction of the investment of the United States

<sup>86</sup> Sec. 4. At current levels of traffic, the payment for passenger and cargo vessels paying tolls on the basis of Panama Canal net tonnage, would be approximately \$43 million. The section provides for adjustment of the 30 cents rate in future years to reflect changes in the wholesale price index.

<sup>87</sup> Article III, sec. 3.

in the canal, such funds of the agency as are in excess of requirements for working capital and foreseeable plant replacements and expansion.<sup>88</sup>

Viewed in that light the provisions of section 4(c) of Article XIII would substitute Panama for the United States as the beneficiary of funds in excess of those required for operating and capital expenses, and effectively precludes further reduction of the U.S. Government's investment in the canal. This, of course, would represent a substantial departure from one of the present laws governing operation of the canal; a matter left by the treaty to the discretion of Congress.<sup>89</sup> In any event, like the provision of Article XIII for annual payments based on the aggregate measurement tonnage of ships using the canal during the year, the qualification introduced by section 4(c) relates to the determination of the amount of the payment, not to the necessity for Congressional appropriations to authorize payment.

The provisions of Article XIII of the treaty for payments to Panama "out of Canal operating revenues" also invite comparison with the provisions of the various acts of Congress referred to above appropriating or making available for expenditure revenues of the Panama Canal without such revenues having been covered into the Treasury. Viewed in that light, the payment provisions would represent an attempt to provide permanent appropriations for the treaty payments, an objective clearly precluded by the constitutional limitation to the Congress of the power to make appropriations.

Finally, it is not considered that the provision of Article XIII section 4(a) for calculation of the payment to Panama to be made annually under that section affects the constitutional requirement that treaty provisions for payment of money be carried into effect by Congressional appropriations. That section provides for payment of an annual amount computed at the rate of \$.30 per Panama Canal net ton, "or its equivalency" for each vessel transiting the canal for which tolls are charged. The rate of \$.30 per Panama Canal net ton "or its equivalency" is to be adjusted periodically for changes in the wholesale price index.

The obvious difference between the payment provided in this section and the annual payments originally provided in the 1903 treaty and modified by the 1936 and 1955 treaties, is that the latter established a fixed sum while section 4(a) of the new treaty provides for a variable annual payment depending on the measurement tonnage of ships paying tolls for use of the canal. Apart from an inherent ambiguity as to the meaning and effect of the phrase "or its equivalency" as used in the section, the required computation is a straightforward arithmetical calculation. The provision for adjustment of the rate per ton used in the calculation to reflect changes in the wholesale price index is new only in the standard applied for the adjustment; annual payments under the existing treaties are adjusted for fluctuations in the price of gold in relation to the dollar. In any event, there is no basis for concluding that the provisions of section 4(a) for calculation of the payment or adjustment of the rate used in the calculation obviate the necessity for appropriations as required for the payments under the existing treaties.

In an early opinion upholding the constitutional validity of a treaty providing for the issuance (but not the payment) of bonds to an Indian tribe, the Attorney General correctly stated the rule applicable to the payments provided by the proposed treaty as follows:

"According to Article I, section 9, of the Constitution, as construed by the practice of the Government, an Act of Congress is necessary to appropriate money to pay the public debt, however created. The change of the form of the debt from a general stipulation in the treaty to bonds with a particular provision does not take away that necessity."<sup>90</sup>

Mr. WHITMAN. The memorandum shows the uniform practice of the Government in reference to the effect of the constitutional provisions involved, and in reference to the treatment of our Panama Canal revenues from the time of construction of the canal, as public moneys

<sup>88</sup> Act of June 29, 1948, § 2, 62 Stat. 1076, now incorporated in 2 C.Z. Code § 70.

<sup>89</sup> Presumably, legislation enacted by the Congress to constitute the Panama Canal Commission would establish fiscal requirements to be met by the Commission as has been done for the present operating agency by the Act of June 29, 1948 (62 Stat. 1076) as amended by the Act of Sept. 26, 1950 (64 Stat. 1041).

<sup>90</sup> XIII Op. Atty. Gen. 354 at 360 (1870).



that are available for expenditure for any purpose, including payment to Panama, only pursuant to appropriations enacted by the Congress.

I think I can probably sum up the basic constitutional conclusion reached in the paper by reading a resolution adopted by the House of Representatives in the administration of George Washington, written by James Madison, which as far as I know, it still represents the law on the subject in this country as follows:

When a treaty stipulates regulations on any of the subjects submitted by the Constitution to the power of Congress, it must depend for its execution as to such stipulations on a law or laws to be passed by Congress, and it is the Constitutional right and duty of the House of Representatives in all such cases to deliberate on the expediency or inexpediency of carrying such treaty into effect and to determine and act thereon as in their judgment may be most conducive to the public knowledge.

Mr. Chairman, I think that is sufficient for this purpose.

I will submit this for the record.

Mr. METCALFE. Thank you, Mr. Whitman.

That concludes our list of witnesses, and it concludes our hearing.

We would like to express our profound appreciation for all of the expert witnesses who have testified before us during these 2 days of hearings.

Off the record.

[Discussion off the record.]

Mr. METCALFE. The proposal has been made to the Chair that because of Mr. Whitman's very wide background in this area that he be permitted to comment on the concepts of the witnesses who have previously testified. I think that would consume a considerable amount of time which we do not have, but I think we ought to ask him to submit a report to us of his evaluation of the witnesses. I think it is a very good idea that you have presented to us.

Would you do that, Mr. Whitman?

Mr. WHITMAN. Yes. [See attached.]

Mr. METCALFE. Thank you very much.

The hearings of the Panama Subcommittee will now be concluded.

[Whereupon, at 4:09 p.m., the subcommittee adjourned subject to the call of the Chair.]

[Pursuant to the unanimous consent request of December 1, the following was submitted for the record by Mr. W. M. Whitman, consultant to the Committee on Merchant Marine and Fisheries:]

#### PANAMA CANAL TREATY PROBLEMS

The written statements and the testimony presented by the various witnesses appearing at the hearing of the Panama Canal Subcommittee on November 30 and December 1, 1977, disclose several clearly identifiable problems of some concern to the Committee and the Congress in the consideration of the Panama Canal treaties and legislation to carry them into effect, assuming they are ratified. Those problems fall into five general categories, namely:

1. The projected deficiency in canal revenues to cover operating costs.
2. The sources of funds to cover the deficiency in canal revenues.
3. The form of the Government agency to be established to operate the canal.
4. Ambiguities in treaty provisions.
5. Constitutional issues.

#### 1. CANAL REVENUE DEFICIENCY

The negotiators and other proponents of the treaty repeatedly have stressed the proposition that under the treaty the operations of the canal are to be self-supporting and that canal revenues are to be used exclusively for payment of costs of the operation without cost to the U.S. taxpayer.

The treaty provides for annual payments to Panama totalling some \$62 million in the first year of operation, exclusive of a contingent payment of an additional \$10 million to be paid to the extent canal revenues exceed expenditures. Other provisions of the treaty transferring income-producing property to Panama will reduce the revenues of the Panama Canal by some \$130 million, partially offset by a reduction of about \$50 million in canal operating costs.

An analysis of Panama Canal revenues and costs in the first year of operation under the treaty in comparison to the estimate provided in the 1978 budget program, which does not include provision for the effect of the treaty, is attached. This analysis is based on a tabulation provided by the Panama Canal Company, adjusted to reflect the same elements of cost as those shown in the 1978 budget and to include additional treaty costs, so far identified, not included in the Company's tabulation. The analysis shows that in the first year of operation under the treaty, Panama Canal revenues will fail to cover costs of operation of the canal and related treaty costs by about \$99 million, exclusive of additional cost to the U.S. Treasury of \$7.7 million. The recovery from canal revenues of operating expenses and all other treaty related costs would require an increase in rates of tolls of more than 60%. If the additional costs to the Treasury of \$7.7 million, referred to above, are excluded from the calculation, the increase in rates of tolls required would be reduced to 56%.

Although the calculations of the insufficiency in Panama Canal revenues to cover expenses summarized above relate to the first year of operation, there is no basis for optimism that the financial results of operation will improve with the passage of time. No detailed analysis of costs and expenses for future years similar to that provided for the first year of operation under the treaty is presently available, but the conclusion to be drawn from the data so far available is that costs will rise at a rate higher than any foreseeable increase in revenues over the period of operation of the canal by the United States under the treaty.

If financial viability of the canal is equated to operation as a self-sustaining enterprise, the venture appears to be doomed from the first year after the treaty goes into effect. This was the thrust of the testimony of all the witnesses who urged or suggested the necessity for absorption of elements of the cost of operation by the Treasury through elimination of interest and depreciation or abandonment of the concept of recovery of the investment of the Government in the canal. There may be reasons to support adoption of such expedients, but the policy of operating the canal on a self-sustaining basis is not one of them.

#### SOURCES OF FUNDS TO COVER EXPENSES OF OPERATION

The ability of the canal to generate additional revenues required to cover canal operating expenses under the treaty lies in (1) possible increases in traffic, and (2) increases in rates of tolls.



*(a) Traffic increases*

The factor cited most frequently as a partial solution to the financial problems of the Panama Canal under the treaty, is the anticipated increase in canal revenues from shipment through the canal of North Slope crude oil enroute from Alaska to the East Coast of the United States. The increase in Panama Canal revenue from this source has been estimated as high as \$30 million a year, but for 1978 the estimate by the Panama Canal Company is \$4 million. On the basis of the latter estimate, the deficiency of revenue in relation to costs would be reduced to \$95 million or \$103 million depending on whether the additional costs to the Treasury, noted above, are considered.

There is general agreement that the increase in revenues resulting from the movement of North Slope oil through the canal will be temporary because of the probability of use of less expensive alternatives such as pipelines. In the near time, the movement of this commodity through the canal will unquestionably improve the financial results of operation of the canal for two or three years, but it will neither eliminate the revenue deficiency in those years nor affect the long-term outlook.

The only other suggestion that canal revenues may increase to offset costs increases, even in part, is based on a presumption that historical growth of the canal will continue at the same rate or at a modified rate in the future. This logic has been rejected by most economists who insist that analysis of future individual commodity movements on established trade routes is the only sound basis for projections of future canal traffic.

*(b) Tolls increases.* As previously indicated, on the basis of the Panama Canal revenue figure projected in the 1978 budget, the increased operating costs resulting from the treaty would require a toll increase of from 56 to 60 percent to put the canal on a self-sustaining basis.

Assuming an increase in revenue of \$4 million from the movement through the canal of North Slope oil in the first year of operation under the treaty, the tolls increase would be reduced to the range of 52 to 57 percent.

Representatives of the shipping industry have indicated that increases in rates of tolls in the amount necessary to make the Panama Canal completely self-sustaining under the treaty are unrealistic and will price the canal out of the market because of the availability of less expensive alternatives.

Apparently, during the negotiation of the treaty there was no attempt at a systematic analysis of the potential canal revenues available for funding the cost of the various provisions eventually agreed to. The draft environmental impact statement, published by the Department of State in August 1977 (42 F.R. 43466) suggested that the assessment of the economic impact of the treaty was then impossible because of lack of data as to the costs of operation of the Panama Canal after the treaty became effective. The final EIS dated December 1977, states that "An initial toll increase in the neighborhood of 30 percent will be necessary to cover the operating costs \* \* \* of the Canal during the new Treaty period. The exact level of toll increases will depend on such factors as:

The structure of the canal operation under the new Treaty, especially its operating cost requirements, and

The short-term impact on Canal traffic of Alaskan oil shipments." (pages 33, 34)

*(c) Appropriations or absorption of costs by the United States*

If tolls revenues cannot be increased in an amount sufficient to make the canal self-supporting, it appears to be obvious that the deficiency in revenues will have to be made up from the U.S. Treasury, either through absorption of part of the costs or by direct appropriations. While the proponents of the treaty have consistently adhered to the position that one of the objectives of the treaty is that the canal continue to be self-supporting, they have also simultaneously proposed that substantial costs of operation of the canal be absorbed by the U.S. Treasury through discontinuance of payment of interest on the investment of the United States in the canal, writing off the investment entirely, and treatment of various costs arising from the treaty as obligations of the Treasury rather than of the Panama Canal. Representatives of the shipping industry and others go further and also propose elimination of depreciation as a cost of operation recoverable from tolls, and payment of interest by the United States on Government funds derived from operation of the canal and deposited in the Treasury.

*Interest on U.S. investment.*—At the Panama Canal Subcommittee hearings on November 30, 1977, the testimony of Administration witnesses indicated general unfamiliarity with the history and purpose of payment from canal revenues of interest on the investment of the United States Government in the canal. Interest was described by those witnesses as “profit” and it was suggested that elimination of the interest payment is necessary to keep the Panama Commission “self-sustaining.” The Deputy Assistant Secretary of the Treasury described the background of the requirement of interest payments as follows:

“One reason that payment was required in 1951 when the Canal Company was established as a self-sustaining business enterprise was to avoid allowing the users to have a subsidized toll or exclusively subsidized toll by requiring that the cost of capital be included in the toll base. That requirement will no longer be necessary because under the new arrangements, the toll will increase in order to meet the costs and requirements under the new treaty arrangements.

“Tolls will approach a more economic level and a need for interest payment as a device in effect to avoid subsidy will no longer be necessary.”

The requirement that the Panama Canal Company pay interest to the Treasury on the net direct investment of the U.S. Government in the Company is found in section 62 of title 2 of the Canal Zone Code. (76A Stat. 8). This provision was originally enacted in 1948 in the legislation incorporating the Panama Railroad Company (62 Stat. 1076) pursuant to the Government Corporation Control Act (31 U.S.C. 841 et seq.), and of course applied to that corporation which had been operated as an adjunct of the Panama Canal since the time of construction of the canal. See *State ex rel Rogers v. Graves*, 299 U.S. 401 (1937).

In 1950, when responsibility for the operation of the Panama Canal was transferred to the Panama Railroad Company, which was renamed the Panama Canal Company, the requirement for payment of interest on the Government's investment in the corporation was continued. (Act, Sept. 26, 1950 (64 Stat. 1041)). The 1950 legislation was based on recommendations of the then Bureau of the Budget, approved and forwarded to the Congress by President Truman. In reference to the requirement that the corporation pay interest to the Treasury, the report of the Bureau of the Budget stated:

“The principle that Federal business enterprises should pay a rate of return on the Government's investment equal to the cost of the money to the Treasury is now well settled. The President recommended in his 1948 budget message that corporations should be required to reimburse the Treasury for the full cost of money advanced to the corporation. There is no reason why the Panama Canal and its adjuncts should be exempted from payment of interest since they are essentially Federal business enterprises.” H. Doc. 460, 81st Cong., 2d Sess., p. 8.

At the Panama Canal Subcommittee hearing on December 1, 1977, Leonard Kujawa, a partner in Arthur Andersen & Co., testifying as an expert on Panama Canal finances, confirmed that interest, as the cost of capital invested in a business, is part of the cost of operation of that business. As such, if a business operation such as the Panama Canal is to be self-sustaining, the revenues derived from the operation must be sufficient to cover interest payments on invested capital.

Conversely, as pointed out in the testimony of Comptroller General Staats, if annual interest payments are not made into the Treasury, the cash position of the Panama Canal Commission would be improved “but it would also reduce Treasury receipts and impact on the overall U.S. budget.”

The amount of the interest payment to the Treasury in fiscal year 1978, shown in the 1978 budget program, is \$19.7 million.

*Depreciation.*—The statutory formula for establishing rates of tolls for use of the canal now includes depreciation as one of the elements of costs to be recovered from tolls.

The discontinuance of depreciation on part of the assets of the canal was another expedient suggested at the hearings for reducing the upward pressure on rates of tolls brought about by the treaty. On the other hand, the Comptroller General pointed out that the property transfers provided by the treaty would necessitate increased depreciation to make possible recovery of the U.S. investment in the canal over the life of the treaty and that “For the proposed Commission to be financially self-sufficient, toll rates would have to be raised to cover these increases in depreciation costs.” The Comptroller



General also noted that these actions "may not be economically sound, because of the impact on toll rates and possible adverse effect on traffic and revenues." In other words, under the treaty it may no longer be possible for the Panama Canal to be self-sustaining.

The property of the United States in the Canal Zone, to be transferred to Panama under the terms of the treaty, was acquired at an original cost of about \$1 billion. The book value of the property associated with the Panama Canal, exclusive of military property, is currently \$752 million.

*Other treaty costs.*—Costs to the U.S. Treasury resulting from the treaty that are not directly and immediately associated with operation of the canal probably could not be included in the tolls formula for payment out of revenues of the canal. These costs have not been completely identified but they appear to include appropriations required to fund part of the economic assistance program under the separate agreement accompanying the treaty, the cost of the joint study for the need for and feasibility of a sea level canal for which the treaty provides, the loss to the Treasury of the payment now being made in reimbursement of capital appropriations to the Canal Zone Government, and possibly the cost to the Civil Service Commission and military departments of employee assistance programs contemplated by the treaty.

### 3. FORM OF GOVERNMENT AGENCY TO BE ESTABLISHED TO OPERATE THE PANAMA CANAL

Legislation to be enacted by the Congress must establish the Government agency to operate the canal and provide the ground rules for its operation.

Article III of the Panama Canal treaty provides that the United States will carry out its responsibilities by means of a U.S. Government agency called the Panama Canal Commission "which shall be constituted by and in conformity with the laws of the United States of America." The treaty also provides that the Panama Canal Commission "shall be supervised" by a Board composed of nine members, five of whom are to be U.S. nationals and four nationals of Panama.

From the time of completion of the canal in 1914 until 1951, the canal was operated by an independent agency called The Panama Canal. The Panama Canal was established and functioned in accordance with the laws of the United States generally applicable to all Government agencies, including the various laws governing the financial management of such agencies now largely incorporated in title 31 of the U.S. Code. Under those laws revenues derived from operation of the canal were paid into the Treasury, and costs of operations were paid from direct appropriations for that purpose.

In 1950, Congress transferred responsibility for operation of the canal to the Panama Railroad Company, a government agency in corporate form that had been used by the United States Government as an adjunct to the operation of the canal from the time of construction of the canal. The corporation was renamed the Panama Canal Company and its operations were subject to the provisions of the Government Corporation Control Act as well as other applicable provisions of title 31 of the U.S. Code. Revenues from the operation of the canal and related activities are deposited in the Treasury or depository banks approved by the Secretary of the Treasury, and expenditures are authorized by the Congress in appropriation acts authorizing the use of such revenues for the purposes set out in the corporation's budget program, as modified by the Congress in the appropriation act.

The 1950 legislation transferring operation of the canal to the Panama Canal Company changed the name of the agency known as The Panama Canal to Canal Zone Government with the responsibility of providing the various services incident to the civil government of the Canal Zone. No basic change was made in the form of organization of that agency. A brief summary of the history and laws applicable to the operation of the two agencies now responsible for operation of the canal and the government of the Canal Zone is included in the separate study of the relationship of the treaty provisions to the Constitutional power of Congress to make appropriations.

In establishing the government agency for operation of the canal under the new treaty, the Congress could select either the corporate form along the lines of the Panama Canal Company, the non-corporate form, following the prototype of the original Panama Canal agency, or some combination of the two. Some of the advantageous features of the corporate form, such as business-type budgeting and audit by the General Accounting Office, have been referred to by

the Comptroller General. On the other hand, the corporate form is particularly useful for business operations that are truly self-sustaining, and if a substantial amount of direct or indirect subsidy is involved, the conventional unincorporated government agency offers the advantages of closer control by the Congress. Of course, if the unincorporated form of agency is selected, the legislation could incorporate provision for business-type budgets and audit by the General Accounting Office.

A related matter of concern is that of providing for the qualifications and method of appointment of members of the Board to be appointed to supervise the Panama Canal Commission. This feature of the legislation will be especially important in view of the provisions of the treaty for division of the membership between nationals of the United States and Panama.

#### 4. AMBIGUITY OF TREATY PROVISIONS

##### (a) *General considerations*

Ambiguities in the language of the two treaties pose serious problems of interpretation that are virtually certain to become the subject of future controversy. Although the U.S. treaty negotiators have offered their explanations of the ambiguous language, those interpretations have often been at direct variance with those published by the Panamanian negotiators. In considering the significance of these diverse interpretations, the United States Government should keep in mind the enumeration of the causes of conflict between the United States and Panama, published by the Government of Panama on the occasion of the rejection by Panama of the new treaties negotiated in 1967. The concluding paragraph of Part I of the document read as follows:

"7. Last, so as not to make the list of causes of conflict interminable, we mention the greatest cause, the constant cause, the cause that has daily contributed to keep alive the resentment of Panamanians and feeds a sentiment of rebellion against the offensive presence in part of the national territory of a foreign Government which acts in an arbitrary, totalitarian and absolute manner, contemptuous toward the presence of the territorial sovereign. We refer to the invariable conduct of the Government of the United States of America of interpreting the clauses of the existing treaties in the manner most convenient to their interests and contrary to Panama's rights and imposing their arbitrary and unfair interpretations with the power in their hands, and that Panama has not been able to counteract to date, of excluding the throwing out of the Canal Zone the official presence of Panama and the enforcement of our laws."

As the quoted statement implies, the diplomatic relations of the United States and Panama have been characterized by almost continuous controversy over the construction of the language of treaties and agreements that the United States usually has regarded as plain and unambiguous. To cite only one example, Article V of the 1942 Agreement for the Lease of Defense Sites in the Republic of Panama (57 Stat. 1232) provided that the defense sites would be vacated "within one year after the date on which the definitive treaty of peace which brings about the cessation of the present war, shall have entered into effect." In 1947, Panama asserted that the surrender of Japan constituted a "definitive treaty of peace" ending the war. The United States did not accept that interpretation, but eventually yielded to pressure and vacated the sites before the peace treaty was signed. The history of this particular disagreement is set out at length in the Department of State's publication *Foreign Relations of the United States for the years 1946* (pp. 1095, et seq.) and *1947* (pp. 881, et seq.).

##### (b) *Payments to Panama.*

Paragraph 4(a) of Article XIII of the treaty provides for payment to Panama of an annual amount of 30 cents 'per Panama Canal net ton, or *its equivalent*, for each vessel transiting the Canal for which tolls are charged." (Emphasis supplied.) A Panama Canal net ton is clearly defined in existing laws and regulations as the basis for establishing rates of tolls for use of the canal. However, not all vessels are susceptible of measurement in Panama Canal net tons; some ships and other craft, such as warships, floating drydocks, etc., pay tolls on a displacement basis. Whether or not, the phrase "or its equivalent" relates to the payment to Panama for ships that pay tolls on displacement rather than "Panama Canal" tonnage is not clear from the treaty provisions. If that is the intent



of the provision, there is no criterion provided for determining what is the equivalent of a Panama Canal net ton in computing the payment to Panama. This could obviously become a matter of controversy and should be clarified before the treaty is ratified.

Paragraph 4(c) of Article XIII provides for a payment to Panama, in addition to other payments, of \$10 million per year "to be paid out of canal operating revenues to the extent that such revenues exceed expenditures of the Panama Canal Commission including amounts paid pursuant to the treaty."

This provision apparently contemplates determination of whether or not the payment is due on a cash basis. If so, and if "expenditures" are limited to payments actually made, excluding unpaid obligations, it could create a serious problem for the financial administration of the canal. The theory of the treaty provisions seems to have derived from the statutory provision that now requires the Panama Canal Company to pay into the Treasury annually the amount of funds in excess of the Company's requirements for working capital and for authorized plant replacement and expansion. (2 C.Z. Code 70). However, there are obvious differences between the language of the two provisions, and it is questionable whether the treaty provision would permit retention by the Panama Canal Commission of funds for working capital or plant replacement and expansion.

The precise meaning of this paragraph of the treaty would become a matter of considerable importance to the financial management of the canal under the new treaty, and its meaning should be clarified before legislation is enacted to carry it into effect.

A third ambiguity appears in paragraph 5 of Article III of the treaty which, after providing for payment to Panama of \$10 million in reimbursement for certain services, goes on to provide that at three year intervals "the costs involved in furnishing said services shall be reexamined to determine whether an adjustment of the annual payment should be made because of inflation and *other relevant factors affecting the cost of such services.*" (Emphasis supplied.) There is nothing in the treaty or other documents accompanying the treaty that defines what other relevant factors are for consideration in the adjustment of the amount of this payment. It was suggested at the hearing that the actual cost of services provided might be one such factor, but it would appear to be desirable to reach a firm understanding, with appropriate documentation, defining the meaning of the phrase in question.

Implicit in all the provisions for payments to Panama is an ambiguity arising from the absence of any language referring to the indebtedness of the Government of Panama to the Panama Canal Company and Canal Zone Government, now aggregating some \$8.5 million. In normal business transactions provision would be made either for set-off of this amount against the payments to Panama or for outright cancellation of the debt. Whichever result is intended, it should be clearly understood by both parties and incorporated in the legislation to carry the treaty into effect.

#### (c) *Property transfers*

Paragraph 1 of Article XIII of the treaty provides that on termination of the treaty, Panama will assume total responsibility for operation of the Panama Canal which shall be turned over in operating condition and "free of liens and debts, except as the two parties may otherwise agree."

At the end of any year of operation of the canal as a continuing business enterprise, there remain and are carried forward obligations incurred in completed periods of operation, such as unpaid employee compensation, liability for unused leave, and other accounts payable, which aggregated \$80 million in 1976, and are estimated at \$87 million in 1978.

Whether or not the quoted provision of Article XIII requires the liquidation of these liabilities before the canal is turned over to Panama is not clear, but the ambiguity should be resolved to permit orderly financial planning and management in the period intervening between the effective date and termination of the treaty.

#### (d) *Use of the canal by U.S. Government vessels*

Paragraph I of Article VI of the neutrality treaty provides that vessels of war and auxiliary vessels of the United States and of Panama "will be entitled to transit the Canal expeditiously." At the hearings on the treaties this provision has been referred to as providing that warships of the United States are en-

titled to priority in transit in case of emergency, but other statements in Panama by the treaty negotiators have indicated that no priority of passage is involved.

The statement issued by the White House after the meeting between President Carter and General Torrijos on October 14, 1977, discussed below, confirms that the provision in question "is intended, and shall be interpreted to assure the transit of such vessels through the canal as quickly as possible, without any impediment with expedited treatment, and in case of need or emergency, to go to the head of the line of vessels in order to transit the canal rapidly."

#### (e) *Defense of the canal*

Article IV of the Panama Canal treaty provides that "Each party shall act, in accordance with its constitutional processes, to meet the danger resulting from an armed attack, or other action which threatens the security of the Panama Canal or of ships transiting it." Article V provides specifically against intervention in the internal affairs of Panama by U.S. nationals employed by the Commission. Article II of the Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal provides that Panama declares the "neutrality" of the canal in order that it shall remain open to peaceful transit of vessels of all nations on terms of entire equality, and Article IV provides that the United States and Panama agree to maintain the "regime of neutrality" established by the treaty "in order that the canal shall remain permanently neutral."

In the light of all these provisions the question has been raised as to whether the United States would be authorized to take appropriate action to keep the canal open if the threat to the operation of the canal originates in Panama. The statement issued by the White House after the meeting between President Carter and General Torrijos on October 14, 1977, states that under the neutrality treaty Panama and the United States have the responsibility to assure that the Panama Canal shall be open and secure to ships of all nations and that each country "shall, in accordance with its constitutional processes, defend the canal against any threat to the regime of neutrality, and consequently shall have the right to act against any aggression or threat directed against the canal or against the peaceful transit of vessels through the canal." The statement goes on to say, however, that this does not mean nor shall it be interpreted as a right of intervention of the United States in the internal affairs of Panama. Any U.S. action will be directed at insuring that the canal "will remain open, secure, and accessible, and it shall never be directed against the territorial integrity or political independence of Panama." Administration witnesses at the subcommittee hearing expressed the view that the treaty gives the United States the right to take whatever steps the United States deems necessary to maintain the neutrality of the canal, no matter what the threat may be.

#### (f) *Joint statement of October 1977*

The statements issued by President Carter on October 14, and General Torrijos on October 18, for the purpose of eliminating the ambiguities in the neutrality treaty are intrinsically ambiguous in themselves.

Apparently the statements were entirely informal. On his return to Panama following his meeting with President Carter, the press reported that General Torrijos emphasized that he had not signed anything on his visit to Washington. Granting that the statement represents the personal interpretation of the treaty provisions discussed on the part of President Carter and General Torrijos, the effect of the informal unsigned statements as amplifications of the language of the treaty is at least open to question.

### 5. CONSTITUTIONAL ISSUES

In addition to the financial problems in operation of the Panama Canal under the new treaties, the treaty language poses two fundamental constitutional problems that are of even greater significance to the United States Government, namely, the requirement for action by the Congress to dispose of property of the United States and to make appropriations of public funds. The treaty language purports to convey property of the United States to Panama and to provide for payments to Panama without action by the Congress as the Constitution requires. These issues are addressed at length in a memorandum on the necessity for appropriations to authorize the payments to Panama presented at the subcommittee hearings on December 1, 1977, and in extensive hearing and briefings conducted by the Committee on Merchant Marine and Fisheries in the first session of the 95th Congress. A further hearing by the Committee on the constitutional issues is scheduled in January, 1978.

Attachment.



JANUARY 9, 1978.

HON. ELLSWORTH BUNKER,  
*Ambassador-at-Large,*  
*U.S. Department of State, Washington, D.C.*

DEAR MR. AMBASSADOR: Mr. W. M. Whitman, consultant to the Committee on Merchant Marine and Fisheries, has, in a paper entitled, "Panama Canal Treaty Problems," entered his comments on the Panama Canal Subcommittee hearings on November 30 and December 1, 1977.

I hereby request that the Department of State comment on Mr. Whitman's important paper. Such comment would be a most important addition to the Subcommittee's hearings on the Economic and Financial Ramifications of the proposed Panama Canal treaties and would be invaluable in any Subcommittee considerations in implementation of the treaties.

Sincerely,

RALPH H. METCALFE,  
*Chairman, Panama Canal Subcommittee.*

Enclosure.

DEPARTMENT OF STATE,  
*Washington, D.C., February 3, 1978.*

HON. RALPH H. METCALFE,  
*Chairman, Committee on Merchant Marine and Fisheries, Panama Canal Subcommittee, House of Representatives.*

DEAR MR. CHAIRMAN: This is in response to your letter of January 9 asking for comments on Mr. W. M. Whitman's paper "Panama Canal Treaty Problems."

I note that a large segment of the paper is devoted to analysis of operating costs under the new Treaties. It should interest you, therefore, to learn that a consultant to the Department is currently developing some cost projects. When we receive the final report in early February, I will provide a copy to the Subcommittee. It is my hope that the study offer considerable insight into the projected operating costs for the new Panama Canal Commission.

In the interim, I am enclosing a point-by-point analysis of the issues raised in Mr. Whitman's paper.

Sincerely,

DOUGLAS J. BENNET, JR.,  
*Assistant Secretary for Congressional Relations.*

Enclosure :

#### POINT-BY-POINT ANALYSIS

##### (1) CANAL REVENUE DEFICIENCY

Mr. Whitman is correct in stating that at the present time, Canal revenues would not cover the additional costs projected under the Treaty. But even without a new treaty, a toll increase might be necessary to meet operating costs. The new Treaty will significantly alter the cost structure of Panama Canal operations; certain functions will be transferred or eliminated, thereby increasing the net revenue and partly covering increased payments to Panama. An increase in toll rates in the neighborhood of 30% will be required to cover the total cost of Panama's annuity.

It should be observed in this respect, that Dr. Ely Brandes has testified before the Senate Foreign Relations Committee that the Panama Canal Commission should have sufficient revenue resources available to meet operating costs; that tolls could safely be raised 75% to 100% and that this step would yield 40% more revenue. This estimate is more optimistic than the revenue estimates developed by our negotiating team during the treaty negotiations, and would allow a much greater increase in tolls than is necessary to provide for the annuity payment to Panama.

##### (2) TRAFFIC INCREASES

Our increased traffic projections are based on an analysis of future individual commodity movements on established trade routes. Mr. Whitman is correct that this is the only sound basis for projects of future Canal traffic. We anticipate that Panama Canal traffic will increase at a projected growth rate of about 2.2% per year. A sharp increase is projected for 1978 and 1979, mostly due to the transit of North Slope petroleum, which will begin to decline in 1980. However, increases in other commodity categories will tend to offset losses in petroleum shipments.

The anticipated toll increases would probably divert small volumes of traffic over time, but Canal traffic would still not reach the point of diminishing returns.

### (3) APPROPRIATIONS OR ABSORPTION OF COSTS BY U.S.

We contemplate that the new Commission, like the present Canal Company, will have the authority to borrow funds from the U.S. Treasury with the obligation to repay. This option would cover any possibility of emergency that should be accorded the Canal operations in the interests of prudent management.

#### (a) *Interest of U.S. investment*

The interest referred to is a measure of the equity of the United States in the Panama Canal developed in the 1950's for accounting purposes. The definition of this equity in the Canal is a function of internal U.S.G. accountancy provided for under current law.

The Administration is familiar with the history and purposes of the requirement that the Canal Company make interest payments to the Treasury. It is a more complex matter than Mr. Whitman suggests. While he is correct that the Canal Company was to operate on the principle that "federal business enterprises should pay a rate of return on the Government's investment," Mr. Nachmanoff, the Deputy Assistant Secretary from Treasury whom he quotes, is also correct in stating that one reason for the interest requirement is to avoid a subsidy to users of the services of these business enterprises. The "subsidy" issue was in fact one of the key issues discussed in 1950 when Congress considered legislation to separate "business" from "government" functions in the Canal Zone. (See, in particular, Hearings on H.R. 8677, Subcommittee on the Panama Canal, House Committee on Merchant Marine and Fisheries, 81st Cong. 2nd. Session, and the Testimony of the Association of American Railroads, which urged that "no subsidy (should) be allowed to the water carriers . . . who are competitors" of the railroads. (Attention pp. 113-114.)

For all practical purposes, the interest requirement became effective in 1951, when President Truman organized the Canal Company and transferred the waterway and other assets to it, and when, pursuant to legislation enacted in 1950, the Canal Company could include interest in the tolls base. Prior to that time, it does not appear that interest was paid to Treasury.

The Administration intends to propose repeal of the interest requirement in the legislation to implement the treaties. This proposal will be based on considerations of national interest as well as on the expectation that the toll increase required to make the Commission self-sustaining will eliminate the need to avoid a possible subsidy. This proposal stems from efforts of the Negotiators to balance three policy objectives: (1) to keep the Commission self-sustaining; (2) to restrict Canal operating expenditures and costs to the Canal users; and (3) to help assure Panama's stake in the efficient operation of the Canal by providing Panama with an equitable share of the benefits of the Canal.

#### (b) *Depreciation*

Mr. Whitman's discussion on this subject does not appear to lead to his conclusion that the Panama Canal will not be self-sustaining under the Treaty. He fails to note that depreciation costs as used by the Panama Canal Company are a means of financing future capital costs of the Canal. During the treaty negotiations, the U.S. team assumed that there would be capital costs in excess of what would be provided by current depreciation techniques. The objective of the Negotiators was to insure that all Canal operating and capital requirements would be sustained by Canal revenues. This objective will be achieved through the use of appropriate accounting techniques.

#### (c) *Other Treaty Costs*

We have consistently maintained that the costs of payments to Panama can and will be met out of Canal revenues. Appropriated funds will only be necessary to implement other Treaty provisions that are not normal operating costs such as those for early retirement and relocation of military facilities.

### (4) FORM OF GOVERNMENT AGENCY TO BE ESTABLISHED

The treaty provides that until the year 2000 the U.S. will have the right to manage, operate and maintain the Canal and that it will exercise these rights through a U.S.G. agency to be called the Panama Canal Commission. It will have a Board of Directors consisting of nine members, five of which will always be Americans.



Under the Treaty, it will be the sole prerogative of the U.S.G. to determine the structure of the Commission. For example, the method of selecting the five U.S. directors is left up to the internal processes of the U.S. The Executive Branch may recommend to Congress that like the Panama Canal Company, it should be a corporate agency of the U.S.G. Regardless of its structure, it will be a self-sustaining agency with revenues produced by operations to cover expenditures.

#### (5) AMBIGUITIES

There has never been any misunderstanding between President Carter and General Torrijos as to the exact meaning of the language of the Treaties. The Treaties clearly delineate our rights until the year 2000 and beyond. The Treaties are self-explanatory about our major rights and responsibilities.

##### *(a) Payments to Panama*

Paragraph 4(a) of Article XIII of the Treaty provides for payment to Panama of an annual amount of 30 cents "per Panama Canal net ton, or its equivalent, for each vessel transiting the Canal for which tolls are charged." The phrase "or its equivalent" refers to the measurement in PCTs for vessels transiting in ballast or on a displacement basis.

Paragraph 4(c) of Article XIII is a contingency payment due only if Canal revenues exceed expenditures. It is understood by the Parties that the "expenditures" referred to would include all actual costs of operation and maintenance of the Canal. These costs would include the payments to be made to Panama by the Commission pursuant to the provisions of the Treaty, funding for plant replacement and capital improvements, and repayment of borrowed funds. The need to finance these costs before making the Paragraph 4(c) payment was made clear to the Panamanian negotiating team. The specific accounting system to be utilized by the Commission is to be established by the U.S. The accounting system should be establishing in such a manner that it will be apparent from looking at the books at the end of the year whether such a surplus exists, and thus no disputes should arise on this question.

Paragraph 5 of Article III provides for payment to Panama of \$10 million in reimbursement for certain public services. The payment for these services will be adjusted every three years to reflect inflation and other relevant factors including the actual costs incurred by Panama, and may be raised or lowered on the basis of each triennial review.

Panama currently owes the Panama Canal Company, Canal Zone Government \$8.6 million. Most of the \$8.6 million represents pre-1960 costs of garbage bills plus a \$4.6 million leprosy bill which increases at a rate of \$37,000 per month.

Some of the debt is in dispute for various reasons. We expect that now that the new Treaties have been signed, we will be able to negotiate a reasonable settlement with the Panamanian Government.

The Treaty grants the U.S. all the rights necessary to operate the Canal, including authority to set tolls. It is contemplated that the Commission will be a self-sustaining entity. Since the U.S. has plenary authority to manage the Canal, Panama should not be saddled with deficits which might be incurred as a result of unilateral U.S. policies of Canal operation. However, the Treaty provides that Panama may agree to assume any liability contracted by the United States in connection with the operation of the Canal.

##### *(b) Statement of Understanding*

It is clear from the Statement issued in Washington and Panama last October that our vessels of war are assured transit through the Canal as quickly as possible, without any impediment. Additionally, it is understood that the U.S. has the right to take whatever action it deems necessary, including the use of military force, to protect the neutrality of the Canal. Panamanian spokesmen have stated publicly that the Neutrality provision would allow the U.S. to take action against any threats to the Canal including those originating in Panama.

The Statement of Understanding is an official interpretation of these two articles. As such, it is not necessary that it be formally incorporated into the Treaty.

#### (6) CONSTITUTIONAL QUESTIONS

It is the position of the Executive Branch that a self-executing Treaty has the power to dispose of U.S. property concurrently and independent of the power of Congress under the Constitution.

On the question of appropriations, the Treaty provides for the measurement and source of the annuity payments. However, the Treaty does not dictate what procedures will be followed in appropriating these monies.

Like all Treaties which include financial obligations, the procedures are left to the discretion of Congress.

STATEMENT OF INTERNATIONAL LONGSHOREMEN'S ASSOCIATION, AFL-CIO, BY  
THOMAS W. GLEASON, PRESIDENT

This statement is filed by the International Longshoremen's Association, AFL-CIO (ILA).

The ILA is the largest labor organization representing longshoremen and other waterfront craft workers in the United States. Its jurisdiction covers ports from Maine to Texas, the Great Lakes and Puerto Rico and other Caribbean ports. In all, the ILA represents over 100,000 men who handle most of the high value cargo that moves in the foreign trade of the U.S.

The ILA views the two Panama Canal Treaties guaranteeing the permanent neutrality of the Canal and the operation and defense of the Canal through the year 2000 as instruments worthy of support. Nevertheless, this union is concerned about certain gaps in the treaty language which gives no guidance with regard to the implementation of toll hikes—a matter which is of great importance to the East Coast shipping and longshoring industry and a matter which we feel strongly that the Subcommittee must take into consideration in formulating its report.

#### I. PREVIOUS TOLL HIKES

Data provided by the Panama Canal Company reveals that transit of the Canal declined following the three previous rate increases, which added nearly 50 percent to the cost of ships using the waterway system.

In 1975, there were some 15,000 canal transits; the following year, transits decreased to 13,000. In the same period, toll revenues decreased from \$143 million to \$135 million; while net tonnage decreased from 136 million tons to 129 million tons.

A fresh boost of some 25 to 40 percent will only accelerate the diversion of cargo vessels now utilizing the international waterway. Unfortunately, any further loss in trade through the Panama Canal will have effects far beyond the Canal Zone since the waterway is an integral element in the vast flow of U.S. foreign commerce that moves through Atlantic and Gulf Coast ports to all areas of the world.

#### II. FURTHER TOLL INCREASES WILL DISCOURAGE CANAL TRAFFIC

Rather than raising additional revenues, higher tolls will result in fewer ships using the waterway as freight shippers turn to alternative methods of moving seaborne commerce. Alternative transport, such as the cut-rate Trans-Siberian Railroad operated by the Soviet Union, or the minibridge system—the practice of moving international containerized cargo by direct land-water routes instead of the all-water route through the Panama Canal—will mainly benefit from higher tolls because the Canal will lose its competitive edge.

A joint statement was filed by the ILA and Council of North Atlantic Shipping Associations last year before this Subcommittee. A copy of this statement is attached hereto for the Subcommittee's attention. You will note that the report points out that approximately 26,000 containers annually are being diverted from the all-water Panama Canal route—to and from the Port of New York alone—and, of course, this major East Coast port handles only a part of cargo shipments destined for the Far East. Moreover, any further reduction of cargo vessel calls precipitated by shippers diverting to rail and truck movements will lead to a reduction in manhours worked which, in turn, leads to a further downward spiral in ship services, including losses in dockage, wharfage, insurance, taxes, and many job opportunities infields both directly and indirectly related to the longshore industry.

The foregoing is not mere prediction or conjecture. Sealand Service, Inc. has notified the ILA that, as of today, it is terminating its inter-Coastal operations between the East and West Coasts of the United States because of the rising costs in this trans-Canal trade. There is, therefore, good and sufficient reason for our conviction that continuing toll increases will further discourage the movement of cargo through the Panama Canal and will have an eventual negative effect on the revenue-producing capacity of Canal operations.



## III. THE NATIONAL ECONOMY

The Panama Canal is a critical element of the U.S. economy and the water-borne commerce that is so much a part of our nation's well-being. Therefore, it is in the national interest that this vital international waterway operate at toll levels that will encourage ocean trade, particularly by American flag inter-coastal carriers, as well as general cargo and container carriers in the foreign trades. As vessel transits through the Canal decline, the economies of American port cities become seriously threatened. But more importantly, the American-flag merchant marine, the largest user of the Panama Canal, will be impeded to a greater extent by uncontrolled and capricious toll increases.

The most significant issue faced by users of the Canal is the impact that a new increase in vessel transit costs will have on the American economy. The Panama Canal is a vital link in major sea routes serving the Atlantic, Gulf and Pacific Coasts, and the millions of tons of cargoes handled by ships in such operations comprise a substantial portion of the gross national product.

With the steady decline in vessel transits we have seen in recent years—as a direct result of three earlier toll increases in a two-year period, coupled with the rapid growth of minibridge movements—it is our opinion that this vital all-water trade route will never again move in the volume of the past if Panama Canal tolls continue to rise without the implementation of clearly-defined legislative guidelines.

Otherwise, toll revenues from the Canal will be less with an increase than they were before the State Department's projected increase of 25-40 percent.

## IV. FINANCIAL PACKAGE OF THE TREATY

The financial package in the Treaty calls for Panama to receive 30 cents per Panama Canal ton from tolls, plus another \$10 million a year from Canal revenues—and as much as another \$10 million a year, if revenues warrant. None of this is derived from direct U.S. tax dollars. In explaining these terms, the Treaty negotiators are seemingly protective of the American taxpayer. Yet, in reality, the proposed Treaty language, as we understand it, creates charges to the American U.S. taxpayer/consumer far in excess of an outright tax burden.

In fact, the International Longshoremen's Association is dismayed, to say the least, by the State Department's recent disclosure that they are only *now* having a study made to determine the feasibility of the financial commitments expected by the U.S. contained in the Treaty's text with regard to future toll increases and toll-setting policies. This study, conducted by International Research Associates, is being made some four months after the two treaties were negotiated and its projected date for completion is mid-February, 1978. While it is clear that the most important source of revenue to Panama will be the payment of 30 cents per Canal ton, payments directly dependent on future Canal transits, it is inconceivable to the ILA that such decisive factors as levels of future toll rates and overall toll-setting policies—matters of paramount importance to the American maritime industry in general and the longshore industry in particular—are left unresolved and unanswered.

## V. ALTERNATIVE MODES OF TRANSPORTATION

The most divisive single issue now facing ports, ocean carriers, stevedores, dock labor and others is the minibridge system of movement. The gradual shift of moving cargoes, and specifically containerized cargoes, by means of a joint rail-water service instead of the all-water route through the Canal, is causing an alarming decline of foreign trade in many U.S. Atlantic and Gulf Coast ports. This, of course, translates into serious loss of job opportunities for the men that our organization represents.

The Federal Maritime Commission only last month agreed to grant a request by the ILA and others to hear our case in determining the legality of minibridge, but it will be several months before formal oral arguments are heard. It is our contention that the minibridge system is unlawful because it illegally diverts ocean commerce from ports to which it is "naturally tributary" and, further, that various transoceanic shipping companies are unfairly absorbing their costs in order to divert cargo traffic from ILA-represented East and Gulf Coast ports. There is no alternate means of cargo transport that impinges upon the American economy more than minibridge.

It means that the Panama Canal is totally avoided and American cargo moves without payment of any tolls. At present, tariff rates for cargoes moving via minibridge are either the same or less than rates for moving cargo via the Panama Canal to or from the U.S. East Coast. Additional toll increases will accelerate minibridge movements.

#### VI. RECOMMENDATIONS

In the development of implementing legislation with regard to the economic factors of the two treaties, the International Longshoremen's Association respectfully requests that the following considerations be made:

- a. That the subject of a toll-setting policy be perspicuously outlined.
- b. That the overall economic affects of alternate modes of transportation as they relate to the U.S. economy be totally reviewed, such as the avoidable utilization of energy by railroads in the instance of minibridge movements.
- c. That the present accounting policies of the Panama Canal Company be reviewed in-depth, with particular emphasis on its annual depreciation charge of \$8.3 million now included in its tolls base rate.
- d. That a separate study be made of alternative methods and competitive services sponsored by the Soviet Union.

The ILA further recommends that a joint labor-management advisory committee be formed immediately, consisting of all segments of the U.S. maritime industry having a vital interest in Canal tolls, for the purpose of implementing these proposals.

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#### STATEMENT OF THOMAS W. GLEASON, PRESIDENT, INTERNATIONAL LONGSHOREMEN'S ASSOCIATION, AFL-CIO, AND JAMES J. DICKMAN, PRESIDENT, COUNCIL OF NORTH ATLANTIC SHIPPING ASSOCIATIONS

This statement is filed jointly by Council of North Atlantic Shipping Associations (CONASA) and International Longshoremen's Association, AFL-CIO (ILA). It sets forth the deep concern of the North Atlantic Port Associations and the longshore labor, employed on the docks on the Atlantic and Gulf Coasts of the United States as to the detrimental effect of announced plans by the Panama Canal Company to again increase tolls. Such increase would be the third increase a two year period.

The result of this threatened action would adversely affect not only the interests of CONASA, ILA and our maritime industry but the national economy as well. It is a matter of tremendous importance to that national interest that the Subcommittee on the Panama Canal, the Committee on Merchant Marine and Fisheries and the entire Congress of the United States take all necessary steps to prevent a further erosion in the use of the Panama Canal by American flag intercoastal carriers as well as all general cargo and container carriers in the foreign trades. The economy of the Port cities on our four great coasts—Atlantic, Great Lakes, Gulf and Pacific—depend on this great waterway. The American Merchant Marine is hurt most by increases in tolls. The ships of our NATO and Pacific allies need the Canal to meet the threat of new shipping and land transportation systems recently developed by the U.S.S.R.

The purpose of this paper is to forecast that any further increase in Panama Canal tolls will impede greatly this nation's and the free world's ability to compete in world shipping.

#### I. THE INTEREST OF CONASA AND ILA

The Council of North Atlantic Shipping Associations (CONASA) is an unincorporated maritime employer bargaining Association, the members of which are the various shipping associations operating in the major North Atlantic ports of Boston, Rhode Island, New York, Baltimore and Hampton Roads. The constituent members of CONASA are the following Port Association:

- a. Boston Shipping Association, Inc.
- b. Rhode Island Shipping Association, Inc.
- c. Philadelphia Maritime Trade Association.
- d. New York Shipping Association, Inc.
- e. Steamship Trade Association of Baltimore, Inc.
- f. Hampton Roads Shipping Association.



Each of the above Associations represent hundreds of steamship companies, marine terminal companies, contracting stevedores and other employers of waterfront labor. CONASA negotiates and administers a Master Contract with the ILA for all ports in the North Atlantic range. In addition thereto, CONASA is directly interested in the protection of the gigantic North Atlantic port facilities and terminals over which billions of dollars of cargo move each year.

The ILA represents waterfront and longshore workers from Canada to Texas on the Atlantic Coast, the Gulf Coast and the Great Lakes Coast. In addition, it represents the longshore workers in Puerto Rico and in other Ports in the Caribbean. The membership of this Union numbers approximately 100,000 workers engaged in the loading and discharging of vessels and in terminal activities in the foreign and domestic trade of the United States.

The affiliated locals of the ILA and the constituent employer associations of CONASA have between them many decades of experience in maritime and waterfront affairs. Their judgment is that never before, in all of that time, has the United States had more to lose unless it takes effective and immediate action to protect its ever decreasing portion of world shipping. This nation, together with its NATO and Pacific allies, must make sure that their shipping is encouraged and that the trade of the free world is protected. Of immediate concern is the impending increase in the tolls of the Panama Canal Company which is threatening mischief of world-wide significance.

## II. THE IMPORTANCE OF THE PANAMA CANAL TO THE AMERICAN ECONOMY

Prior statements before this Sub-Committee have sought to evaluate the Panama Canal problems on a minor dollar and cents basis. Questions such as—Is the Panama Canal properly charging depreciation?—Is the Panama Canal presently charging bad debts to users who have paid their tolls?—Is the Panama Canal presently allocating non-user costs to users?—are all of significance. However, analysis of such questions fails to reveal the one major issue which this Sub-Committee should focus upon: What will the effect of future increases be on the American economy? The comments of certain representatives of the Panama Canal Company, seemingly protective of the American taxpayer, are in reality creating charges to that taxpayer far in excess of any claimed deficits.

Of the approximately 140 million Canal tons which moved in fiscal year 1974, 96 million tons were tons moving from or to the United States and each of its sea-coasts. The trade routes served were: the East Coast of the United States to Asia; the East Coast of the United States to the West Coast of South America; the West Coast of the United States to Europe; the West Coast of the United States to the East Coast of South America; the United States Intercoastal trade; the East Coast of the United States to the West Coast of Canada; the East Coast of the United States to Oceania; the West Indies to the West Coast of the United States; and the West Coast of Central America to the East Coast of the United States. These nine trade routes represented almost 70% of the tonnage moving through the Canal in that fiscal year. More than 17% of the United States' total world trade has moved through the Canal in the past. This trade will not continue to move in such numbers and in such quantities if the Canal tolls are again increased.

In fiscal year 1974 over 15,000 transits were made through the Canal. This year, with the recession behind us, total transits are estimated at the level of about 13,000, a regression back to the period of 1965. The toll increases of 1974 and 1976 are beginning to have their effect in Canal transits. Studies show that 15% increases in tolls impact such transits. The two increases in two years total almost 30%. Obviously, cargo is looking for other methods of moving.

What are these other methods of movement? Canal Zone transits are presently being impacted by the following:

A. Mini-Bridge: (i) Far East to and from East Coast with Continental U.S. transit by rail rather than by Canal.

(ii) Eurocal Mini-bridge—movements to and from California to Europe with continental U.S. transit by rail rather than by Canal.

(iii) Land-bridge—movement from the Far East with movements across the U.S. Continent by rail rather than by Canal.

B. Far East to European Traffic: (i) Movement through the Suez rather than through the Panama Canal.

(ii) Trans-Siberian Railroad—movement by rail from the Far East across the U.S.S.R.

### C. Use of the Straits of Magellan or the Cape of Good Hope.

Of all the above, those which impact the American economy the most are Mini-bridge. Here, the Panama Canal is totally avoided and American cargo moves without payment of any tolls. Millions of tons of cargo have been diverted to Mini-bridge.

At the present time, the Tariff Rates for cargoes moving via Mini-bridge are either the same, or less than, rates for moving cargo via the Panama Canal to or from the East Coast. Any additional increase in tolls will accelerate Mini-bridge movements. Additional millions of tons of Far East Cargo will be impacted. Similarly, other cargoes now moving by the Canal will move to the Suez or Trans-Siberian Railway system. United States Intercoastal traffic will be unable to compete with rail and will all but disappear except possibly to Puerto Rico and the Caribbean Islands. The end result will be that the total revenues of the Canal will be less with the increase than they were before the increase.

The philosophy presently applied by the Panama Canal Company would be to again increase tolls and thus lose more cargo in an endless cycle. The inexorable result will, of course, be a diminution in the cargo moving in the foreign trades of the United States to the detriment of our national economy. Only higher value cargo can afford minibridge because of minimum rate schedules. Low value cargo may not be able to move at all. Any transportation system which believes that the answer to its problems is an endless round of rate increases soon finds that it has brought about its own economic obsolescence. Such a policy is contrary to the interests of the United States.

Permitting actions which must bring a decline in the tonnage of the Panama Canal is similar to the disinterest which this Country has shown in maintaining its own Merchant Marine. While the other major nations of the world have been encouraging the build-up of their fleets, the United States has been presiding over the decline of its Merchant Marine. It has fallen from the world's greatest Merchant Marine power in the period after World War II to almost last place among the major seafaring countries of the world. The approximately 500 privately owned vessels flying the American Flag today are to be compared with the 2,400 merchant ships presently operated by the Soviet Union (with many hundreds more now being built). In contrast the United States has failed to nurture a necessary interest in the seas as a necessary implement of defense and has forgotten the lessons of history. The Bicentennial Anniversary is a proper time to remember the importance placed upon the Merchant Marine by the nation's founders who strongly believed in the freedom of the seas and the development of a vigorous and vibrant Merchant Marine. Thomas Jefferson was right when he said:

"As a place of industry our navigation is valuable, but as a measure of defense it is essential."

Our defense, our national interests and those of our allies require that the Panama Canal be maintained as a useful adjunct to our sea power and that it not be permitted to price itself out of the market place of the world trade. Means presently exist to preserve the present rate structure and to accelerate the movement of traffic through the Canal. Pronouncements of the Panama Canal Company, that it will seek additional increases in excess of 20% in the near future, hurt its chances for the recovery of over 2,000 lost transits as shippers prepare today for alternative means of transportation on or after the effective date of the new toll increases.

CONASA and ILA firmly believe that new toll increases will devastate our economy. Too many new alternatives and competitive methods—some sponsored by the U.S.S.R.—will take away our trade.

### III. THE PANAMA CANAL COMPANY SHOULD HANDLE ALL FINANCIAL PROBLEMS UNDER THE EXISTING STATUTORY SCHEME AND PROPOSED AMENDMENTS. NO FURTHER INCREASES ARE NECESSARY NOR SHOULD THEY BE PERMITTED

The importance of the Canal to the United States and its allies require its continued availability at tolls competitive with the above alternate methods of cargo movement. Moreover, the world shipping industry must be assured of the profound interest of the United States in protecting such availability into the far future. The statement made by the Hon. Leonor K. Sullivan, Committee Chairman at the Panama Canal Sub-Committee hearings on Tuesday, April 6, 1976, deserves repetition:



"The History of the Panama Canal from 1879 to the present time consists in large measure of a series of crises, some of them major ones. Today, it faces what in some ways may prove to be one of the gravest in its history \* \* \*

The ultimate end of the process now in progress can only be the surrender of U.S. Sovereignty over the Canal Zone to Panama \* \* \*

It is not the purpose of this paper to further comment on matters pertaining to the renegotiations of the Treaty with Panama. IIA and CONASA believe that Congress should make the policy which is necessary to guide the Treaty makers. It is evident, however, that the Treaty making activities are having an adverse effect on the administration of the Panama Canal Company, its personnel policies, and the morale of its able employees.

The Congress is urged to strongly support the long-term availability of the Canal to all ships of all nations without any further increases. Valid methods exist to protect the Canal without increases. Various commentators who have appeared before the Sub-Committee have set forth their views as to changes in the finances of the Company which are available to avoid toll increases. CONASA and IIA believe that toll increases must be avoided to prevent great harm in the national economy far exceeding the amount of any alleged Company losses. We do not claim any special expertise in this area. However, we will comment on three changes which we believe have merit and should be adopted:

#### *Depreciation*

The unilateral action of the Panama Canal Company in charging depreciation against land, titles, excavations and treaties, should be reversed. No such charge was levied in the period from 1914 to 1974. Arbitrarily, and without Congressional or any other approval, the Company has begun to depreciate such properties, valued at some \$333,000,000, over a forty year period. The \$8,300,000, depreciation taken in each fiscal year since 1974 now amounts to \$24,900,000, a figure exceeding losses to-date. In brief, take away the depreciation and there is no loss.

#### *Improper charges and allocations*

There are two charges which should be eliminated from the Panama Canal Company accounts. One of these is a new reserve for bad debts which exceeds Five Million Dollars a year. The reason this charge should be eliminated is that all carriers using the Canal are required to either pay tolls in advance or establish appropriate deposits for payment. Not one penny of the bad debts carried by the Panama Canal Company are attributable to a single carrier. Second, the Statute (Title II, Canal Zone Code § 412) provides that tolls are to be used to pay "... only an appropriate share of the net costs of the operation of the agency known as the Canal Zone Government". There are many Canal Zone Government costs which have not been properly allocated and which have been improperly charged to users of the Canal. Proper allocation would reduce the amount to be assessed against tolls by many millions of dollars.

#### *Interest*

The Statute also provides that tolls are to be fixed at a level which would take into account interest payments by the Canal Company to the U.S. Treasury. At the present time, approximately Sixteen Million Dollars in annual interest payments will be due to the United States Treasury on the U.S. Canal investment. The St. Lawrence Seaway has been financed without any interest charges. It is recommended that Statutory changes be made to eliminate interest charges to the Panama Canal Company in order to permit a stability of rates over a period of many years.

In the alternative, CONASA and IIA would support the provisions of H.R. 12641, sponsored by the Chairman of the Sub-Committee, the Chairman of the House Committee on Merchant Marine and Fisheries and the Chairman of the Transportation Expenditures Sub-Committee. Under this Bill, the deposits of the Panama Canal Company with the United States Treasury would in effect receive interest. Second, the legislation would permit deferred interest charges to be added to the United States investment in the Canal. Presently, the statute requires that any deferred interest be repaid out of future years net earnings. While H.R. 12641 is helpful, it would not eliminate the Company's request for toll increases. Serious consideration should be given to eliminating the interest charge completely.

Such elimination of interest would permit a stability in Panama Canal tolls over a period of many years and restore shippers' confidence in the use of the

Canal. It would also permit the Panama Canal Company to develop a fund for improvements and capital expenditures. CONASA and ILA suggest that their proposal is a far better method than the arbitrary depreciation method seized upon by the Panama Canal Company for such purpose.

The small investment that the above changes require would pay tremendous dividends in the revitalization of Canal use and would benefit unmeasurably our national economy.

#### IV. OUR NATIONAL POLICY SHOULD ENCOURAGE THE USE OF THE PANAMA CANAL AND THE SAVING OF ENERGY AND OTHER NATIONAL RESOURCES

While the United States is about to toll its intercoastal merchant fleet out of business, the rest of the world is building up the use of intercoastal sea-ways and in-land waterways. Experience has shown that the use of the feedership, the barge, the lighter, the tug and tow and other similar devices are effective, energy saving and inexpensive methods of transportation when compared with rail or other land transportation. Northern Europe is replete with feeder and ferry services connecting Scandinavia to the Continent and to the British Isles, the United Kingdom to the Continent, and the Continental Countries to one another by means of intercoastal and inland water systems. The United States down to 15 intercoastal liners, has yet to learn that lesson.

The Coastwise and Intercoastal traffic of the United States moving between the East Coast and the West Coast has all but disappeared. Where once thriving ship traffic carried the West Coast's lumber and agricultural products to the East and the East's manufactured products to the West, today only 15 American Flag liners supply that trade. Most of these ships are over-age. Some 150 intercoastal ships moved cargo in that trade at the outbreak of World War II. Most of these ships served as the base of our Merchant Marine power in that War. Very few of them were ever replaced when the war ended.

It is necessary and essential that the intercoastal services of the United States be encouraged. Many attempts are being made to this very day to accomplish just that. When a ton of vital goods can move from one coast to another with approximately half the fuel consumption necessary to move the same cargo by inland transportation, the ultimate effect on the conservation of energy is obvious. However increases in Panama Canal tolls in 1974 and 1976 have adversely affected many plans for effective economic utilization of this important waterway. Any further increases may well mean the end of intercoastal traffic. This result would be a tragic one for the United States. Proposals must soon be made for rebirth of the intercoastal service of the United States. Such proposals would have fiscal efficacy only if Canal Zone rates are not increased.

#### V. CONCLUSION

CONASA and ILA respectfully suggest the fiscal problems of the Panama Canal Company are small in comparison to the mischief which will be wrought on the American national interests if a third toll increase in two years is permitted to go into effect.

CONASA and ILA understand that mere words—such as the ones sincerely put forth in this statement—are not enough. Any group making such statements must be prepared to support them with hard work and dedication. For this reason, CONASA and ILA suggest that there be created a Labor-Management Advisory Council, which would be given full authority to advise and consult with the Panama Canal Company before any important determinations are made. It is our suggestion that such Council consist of representatives of carriers, ports, and employer groups, as well as all labor organizations with a vital interest in the Canal. CONASA and ILA would gladly serve on such a Committee.

We stand ready to meet at any time on the implementation of this suggestion.

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STATEMENT BY G. MICHAEL SCHLEE, DIRECTOR, NATIONAL SECURITY/FOREIGN  
RELATIONS DIVISION, THE AMERICAN LEGION

Mr. Chairman and members of the subcommittee, the American Legion appreciates this opportunity to present its views on the economic and financial ramifications of the proposed treaties with Panama. It is a matter of public record that the United States has a great financial investment in the Panama



Canal and, under the terms of the proposed treaties, our nation will continue its tremendous economic involvement. However, we seriously doubt whether the proposed pacts sufficiently protect this financial stake.

Before proceeding with our analysis we wish to commend the subcommittee for convening these hearings and, thereby, providing a public forum to examine a matter which has been overshadowed by the philosophical debate on such items as the national security and foreign policy components of the treaties. It is time that the American people learn what financial risks the U.S. will be taking if these agreements are ratified.

At the outset, we believe that it must be clearly established that the Panama Canal is of significant economic importance to our country. Former Secretaries of State Rusk and Kissinger attested to this in testimony before the House International Relations Committee in September. Examples to support our belief are readily available. For instance, in 1975 some 13,600 ships passed through the Canal. Forty-five percent of them originated in the U.S. and another twenty-three percent were U.S. bound. Of course, there are those who would argue this point by citing the statistic that only a small percentage of the ships that transit the Canal are U.S. flag vessels. However, this argument fails to recognize the fact that the vast majority of exports from and imports to the U.S. are carried on vessels with foreign flags. In fact, less than 5 percent of all U.S. oil imports are shipped on American flag vessels.

Further proof of the Canal's economic importance to this nation is clearly seen when examining the traffic at U.S. ports. We find that more than half of all grain exports, one of our leading export commodities, leave this country through Gulf Coast harbors. One-third of this grain passes through the Panama Canal. Coal, steel, and other products leaving such ports as Hampton Roads and New Orleans utilize the Canal to even greater degrees.

Administration witnesses have consistently stated that the rationale for negotiating a new agreement with Panama was to insure an open accessible Canal, that the proposed treaties are the best guarantee of open accessibility, and that failure to ratify these treaties might lead to conflict sufficient to close the waterway. We believe that ratification might be the most effective way to close the Canal. We believe that the treaties' financial arrangements and Canal management structure have inherent weaknesses which threaten the Canal's current position as a competitive means by which to ship goods in the international market.

Perhaps the most obvious threat to its competitiveness is the proposed toll increase of 25-40 percent which is programmed to take place soon after ratification. In reaction to this proposal, Mr. Edward S. Reed, New Orleans Port Director recently stated that: "Since grain exports are the United States' best source of balance of payments loans, I think it is incumbent upon the Federal Government to closely scrutinize the possible effects of canal toll increases on the farm commodities exported from the United States." Would the U.S. agricultural community, an already hard pressed sector of our economy, be able to withstand an additional cost of this sort and remain competitive in the world market? We do not think so.

When discussing a toll increase it is reasonable to ask what impact such action would have on future Canal traffic. Experts estimate that traffic would decrease slightly during the first year of the increase but the full impact would not be felt until some five years later. Previous toll hikes in 1973 and 1976 and traffic records of succeeding years offer historical support for these estimates. Since 1974 net tonnage being transported through the Canal has dropped from 148 million to 122 million—an 18 percent decrease. If these estimates continue to hold true the impact of the 1973 and 1976 increases will not be fully recognized until four years from now. An additional increase as proposed could have devastating consequences.

With each such increase the Canal continues to price itself out of competition. Already alternative shipping methods are being studied and even implemented. For example, the danger and cost of making the passage around Cape Horn are being overcome.

The negotiators of the new treaties expect that the toll increase will generate enough revenue to make increased annual payments to Panama. However, this additional revenue is tied closely with an estimate that several hundred thousand barrels of Alaskan oil will pass through the Canal daily. It is likely that Alaskan oil will provide additional toll revenue over the short term but the shipment of that oil across the U.S. by pipeline is a very real possibility in several years; thus, denying the Canal its projected source of additional revenue.

In our opinion, this proposed toll increase is poorly conceived and ill-timed. We believe that the proposal of an immediate toll increase after the treaties go in effect is somewhat inconsistent with the stated purpose of the negotiations. It is projected that the additional revenue generated by the oil increase will provide funds for some \$20 million in annual payments to the government of Panama. Of this total, \$10 million is a guaranteed payment and the remaining \$10 million is to be paid out of Canal surplus funds. If, as stated by the administration, Panama and the U.S. are embarking upon 20 plus years in a co-operative venture to insure an open, accessible, and efficiently operated Canal then why must the government of Panama be presented with a \$20 million anniversary gift each year? Why can't this money be plowed back into the Canal operation to enhance its efficiency by improving the facility?

What happens if the Canal operates at a deficit until the year 2000 with no surplus funds available to pay the annual \$10 million bill? Our interpretation of the treaties suggests that this guaranteed payment imposes a cumulative obligation which means that the U.S. could have a \$200 million indebtedness to Panama by the year 2000. Why must the U.S. assume all financial risks and Panama assume none? Is this the administration's concept of the spirit of co-operation and its demonstration of insuring that Panama has a strong economic stake in the efficient operation of the Canal?

As previously stated, we also have serious doubts about the treaties' provisions regarding the Canal's management structure. The managing body, the Panama Canal Commission, will be a U.S. government agency with a board of directors consisting of U.S. and Panamanian employees.

It is imperative, though unlikely, that the Commission remain independent and autonomous, free of all politics. We believe that the Panamanian members of the board of directors will be political pawns of the Torrijos regime. If, as expected, such political intrusion does occur then the Commission will suffer from the "too many bosses syndrome." Further, it seems as though the U.S. will act as financial guarantor of the Canal operation through its involvement in the Commission. There appears to be no alternative available to the Commission in times of financial adversity but to seek assistance from the U.S. treasury. In fact, Ambassador Bunker told this subcommittee several days ago that the administration would recommend to Congress that the Commission have borrowing authority from the U.S. treasury. If in the event the Commission operates at a deficit for an extended period and exercises such borrowing power without fully repaying its debt by the year 2000, then what guarantee does the U.S. treasury have to insure repayment of that indebtedness? We believe that there is no guarantee because, under the treaties' terms, the Commission must relinquish control of the Canal operation in the year 2000 free of lien or debt. The treaties provide the government of Panama with three annual payments—(1) \$.30 per ton for every ton of cargo passing through the Canal which, based upon the most recent figures, would total at least \$37 million (2) a fixed annuity of \$10 million and (3) an amount up to \$10 million paid out of Canal operating revenue surplus. These payments total \$57 million as compared to \$177 million spent by U.S. government agencies in Panama during 1976—money which was spent for goods purchased by U.S. agencies (\$29 million), wages paid to non-U.S. citizens (\$108 million), and earnings spent by U.S. employees (\$39 million). Obviously, the \$57 million payment to the government of Panama is very appealing to the Torrijos regime. But the Torrijos regime would be wise to take another look at this money because it comes right off the top of Canal operating revenues and, thus, seriously jeopardizes the Canal's role as Panama's major employer. How much of the \$108 million in wages will be lost in workforce reductions? How much of the \$57 million will actually be circulated throughout the Panamanian economy?

Finally, we wish to examine the cost of this new setup to the American taxpayer/consumer. The American consumer is a large purchaser of goods which transit the Canal and will have to pay higher prices for those items because of increased tolls. Since the major portion of any revenue generated by such tolls is projected to come from the shipment of Alaskan oil then Americans, as sole consumers of that oil, will pay the bill. If, as suggested, the Panama Canal Commission is granted borrowing authority from the U.S. treasury then any outstanding debt in the year 2000 will be repaid to the treasury by the taxpayers of this nation. If, for any reason, the Canal is unable to operate with a \$10 million surplus per year until 2000 then U.S. taxpayers will likely be required to fund the deficit.



It is readily apparent that the so-called "partnership" between the U.S. and Panama under the proposed treaties is actually a "benefactor-beneficiary" relationship. This nation is assuming every economic risk while Panama is assuming none. This nation will receive relatively no monetary compensation while Panama will benefit greatly. All of these arrangements have been established in the pursuit of continued assurance of an open, accessible, and efficiently operated Canal when, in fact, many of the same arrangements are major obstacles put squarely in the path of that pursuit.

There is a possibility that implementing legislation might shore up some of the weaknesses in the treaties' financial arrangements but we firmly believe that only renegotiation would remedy several of the basic ills referred to in our presentation. Of course, your constitutional roles as members of the House would require that you concentrate on implementing legislation—something that was promised by the administration during testimony before the International Relations Committee in September and again in testimony before this subcommittee several days ago. It is truly unfortunate that the administration is treating your constitutional authority in such a cavalier fashion.

During this presentation we have asked a number of questions pertaining to the economic and financial ramifications of the proposed treaties with Panama. None of the answers based upon information now available are particularly reassuring.

## APPENDIX

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### QUESTIONS OF SUBCOMMITTEE CHAIRMAN METCALFE FOR VARIOUS WITNESSES PURSUANT TO HEARINGS ON THE ECONOMIC AND FINANCIAL RAMIFICATIONS OF THE PROPOSED PANAMA CANAL TREATIES

#### QUESTIONS FOR U.S. TREATY NEGOTIATORS

1. What is the cost of the study now being conducted by the International Research Associates to forecast Canal traffic and to analyze the potential long-term effects of toll rate increases?

A. The contract with the IRA provides for a payment of \$72,650. Of this total the Panama Canal Company will defray \$37,650 and the Department of State \$35,000.

2. If, in implementing the proposed Canal treaties, there were to be enacted legislation on the tolls formula which included a surcharge on vessels (as mentioned in the statements of witnesses Steers and Kujawa), in your opinion, would a portion of that surcharge have to be paid to Panama under the auspices of Article XIII 4(a) of the proposed Canal treaty, or would this charge, since it would not be directly related to tonnage, be exempted from payments to Panama?

A. The payments to Panama under Article XIII 4(a) of the Treaty would not change as a result of a surcharge on vessels transiting the Canal. Of course, any change in the method of calculating toll payments which would modify the Panama Canal ton as the basis for assessing tolls would require a change in payments to Panama from \$.30 per Panama Canal ton to an equivalent amount per new unit of measurement.

3. There are a number of Panama Canal Treaty provisions which have financial implications and which are qualified by phrases indicating that further agreement may modify that provision (e.g., in Article XIII the U.S. obligation to deliver the Canal in operating condition and free of liens and debts, except as otherwise agreed).

How would such modifications take place? Would the modifications be through treaties, or an exchange of diplomatic notes, or Executive agreements?

Is it possible to speculate on how Congress may be involved?

A. The form of any further agreements between the United States and Panama concerning specific provisions of the Panama Canal Treaty would depend upon the substance of such agreements.

Any formal amendment of the Panama Canal Treaty would of course itself be a treaty and would therefore require the advice and consent of the Senate to ratification.

Agreements that implement the Treaty but require separate funding would have to provide for Congressional approval of such funding.

Other implementing agreements may be concluded through executive agreements, which may take the form of an exchange of notes. The Administration will consult closely with the Congress on both the form and the substance of such executive agreements.

4. Are there any provisions of the Territorial Sea Convention of 1958 which will have an important bearing on the terms of the proposed Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal?

A. No. Panama is not a party to the Territorial Sea and Contiguous Zone Conventions, consequently there are no legal obligations between the United States and Panama as a result of that Convention. Even if Panama were a party, the provisions of the proposed Treaty Concerning the Permanent Neutrality and Operation of the Canal are not inconsistent with those of the 1958 Territorial Sea and Contiguous Zone Convention. For this reason legal rights and obligations that the United States has with third States that are parties to the 1958 Territorial Sea and Contiguous Zone Convention are not impaired by the provisions



of the proposed Treaty Concerning the Permanent Neutrality and Operation of the Canal.

#### GAO RESPONSES TO QUESTIONS

*Question 1.* The Governor suggested that under the proposed treaty relationship consideration be given to authorization for inclusion in the tolls base of capital requirements in excess of depreciation, with the requirement that funds so generated be reserved for such purpose.

*a.* What would be the advantages and disadvantages of such an inclusion?

Answer. The Panama Canal Company meets its capital requirements from funds generated from the inclusion of depreciation in the toll base and from retained earnings. However, in recent years the Panama Canal Company has sustained a loss and capital expenditures have not materially exceeded revenue flows from depreciation.

Inclusion in the tolls base of capital requirements in excess of depreciation would assure that users would pay for the costs of maintaining the Canal in an operable condition and reduce or eliminate the possible need for the successor entity to seek funding from appropriations by the Congress or other sources to maintain the viability of the Canal.

The Panama Canal Company is now in the process of reviewing its 5-year capital program, covering fiscal years 1979-83, in light of the treaty. When the Company has completed this review and any necessary modifications, we will be in a better position to comment on its magnitude of capital requirements and its plans for meeting such requirements.

*b.* Based on any material collected in GAO study of Canal finances, would such an inclusion have a significant effect on the rates of tolls for the Canal?

Answer. Where capital requirements materially exceed the amount of revenues generated from depreciation the excess would have to be an additional element in the toll structure to avoid the need for obtaining capital from other sources. At this point in time, we do not have an estimate of the amount required but with increased age of the facility and with increasing costs the effect could be substantial.

A study sponsored jointly by the Panama Canal Company and the State Department is currently in progress. The objectives of the study are to (1) develop a set of projections of Panama Canal traffic and revenues up to the year 2000 and (2) analyze sensitivity of the Panama Canal traffic to toll increases. The study is scheduled for completion in February 1978. Until information from this study becomes available, the ability of the Panama Canal to generate sufficient revenues to meet the provisions of the treaty remains uncertain.

As a part of our responsibility for the audit of the Panama Canal Company we plan to independently review the results of the study.

*Question 2.* Mr. Brandes stated on the second day of economic hearings, December 1, that he had doubts as to the necessity of recovering investment in a public works project such as the Panama Canal. Please comment on this statement, indicating the reasons why the General Accounting Office has been concerned about repayment of the U.S. investment, and the equity that should accrue to the taxpayer, Canal user, etc. in the financial administration of the Canal.

Answer. The Act of September 26, 1950 (Public Law 841, 81st Congress) prescribed the following tolls formula:

"Tolls shall be prescribed at rates calculated to cover, as nearly as practicable, all costs of maintaining and operating the Panama Canal, together with the facilities and appurtenances related thereto, including interest and depreciation, and an appropriate share of the net costs of operation of the agency known as the Canal Zone Government."

This language broadly requires that interest and depreciation costs of facilities and appurtenances involved in the operation and maintenance of the Canal should be made a basis on which the toll rates will be calculated.

The principle of recovering the Government's investment through rate charges in business-type enterprises is well established by such examples as the Tennessee Valley Authority, the St. Lawrence Seaway Development Corporation and various water resources projects, and the Bureau of Reclamation projects.

In our opinion, the practice currently followed by the Panama Canal Company in establishing tolls is consistent with the provisions of the legislation and is in accordance with generally accepted principles as they relate to a rate-regulated business.

## RESPONSES TO QUESTIONS OF THE CHAIRMAN BY THE SECRETARY OF THE ARMY

*Question 1.* Mr. Steers, in his testimony on December 1, suggested that the top financial positions in the Panama Canal Commission be reserved for U.S. citizens, since it is the United States which has the responsibility to the year 2000 for finances of the Canal and payments to Panama under the terms of the proposed Panama Canal Treaty. What are your comments on this suggestion of Mr. Steers? Would the reservation of these positions under the Commission be a violation of the obligations of the United States under the terms of the proposed treaties?

*Answer.* I would not concur with Mr. Steers on this issue. The Panama Canal Treaty is intended to establish a new cooperative relationship with Panama in which Panamanians are treated as partners. It is our responsibility to prepare Panama to assume full control of the Canal in the year 2000. We cannot accomplish these goals by excluding selected positions from occupancy by Panamanians. In my view, a procedure to reserve these positions would be a violation of both the letter and spirit of the new treaties.

*Question 2a.* If the U.S. designates a stockholder of the Canal enterprise under the proposed treaties, need that stockholder be a member of the board of the Commission?

*Answer.* Not necessarily. Under certain circumstances it might be desirable to have the stockholder sit as a member of the Board while under other conditions it might be preferable to have five United States citizen Board members plus a United States citizen stockholder acting outside the Board. This is a matter which should be left to the discretion of the President. Executive Branch flexibility, as authorized in current law, is in my view most desirable.

*Question 2b.* Should at least one of the five U.S. members of the Board have a major interest in and knowledge of the U.S. financing of the Canal? If not, how are the financial interests of the United States to be best represented?

*Answer.* I believe that it is desirable to have at least one member of the Board of Directors knowledgeable in financial affairs. Again, however, I would not stipulate such in legislation, in that, other specialities may for one reason or another be more critically needed on the Board. The President or his designated representative should be allowed to exercise their best judgment in this regard, as is currently provided for in the law.

*Question 3.* Personnel costs of the Panama Canal Commission are likely to be a major factor in determination of the rates of tolls and the general financial viability of the Canal Commission under the proposed Treaty. As you indicate, at present the Canal Zone Civilian Personnel Policy Coordinating Board makes personnel policy for Canal Zone agencies. Who will make personnel policy for the proposed Commission? Who will make personnel policy for the other U.S. agencies that continue to operate on the Isthmus of Panama?

*Answer.* So long as the United States has responsibility for operation of the Canal we must have the final say in determination of personnel policy for Commission employees. However, in view of the fact that Panama will be playing a larger role in the operation of the Canal, I would expect citizens of that country to be increasingly involved in the development of personnel policy. The Board of Directors, on which the United States will have a majority until the year 2000, may, therefore, be the appropriate element to determine overall personnel policy for the Commission. In the future I would expect other United States agencies operating on the Isthmus of Panama to have their personnel policy set primarily by their agency heads as is the current practice in other overseas areas. There will, of course, continue to be a need for the joint development and/or coordination of certain personnel policies and activities in the Panama Canal area. This can be accomplished through the continuation of a Board whose functions would be similar to those of the current Canal Zone Civilian Personnel Policy Coordinating Board.

## RESPONSES TO THE PANAMA CANAL SUBCOMMITTEE QUESTIONS BY GOVERNOR OF THE CANAL ZONE

1. Sea-Land Service, Inc. has recently indicated that it is terminating its intercoastal operations. It is the Subcommittee's impression, however, that Sea-Land rerouting may cause an increase rather than decrease in canal transits.

*Question.* How does Sea-Land's decision affect the annual number of transits and the amount of toll revenues to be collected?



*Answer.* Sea-Land has informed the Panama Canal Company that effective January 10, 1978, they will be discontinuing their intercoastal U.S. service through the Canal. This service currently results in about 35 transits and \$650,000 in tolls revenue annually.

The Panama Canal Company has also been informed that Sea-Land plans to initiate a Kingston, Jamaica to Balboa service. This service would be provided on a weekly basis by one small container vessel and, on an annual basis, would generate approximately 100 transits and \$300,000 in tolls revenue.

The net loss in tolls revenue from the Sea-Land rerouting would be approximately \$350,000 at current toll rates, although transits could increase by about 65 vessels.

*Question.* How does Sea-Land's decision affect the projected net revenue deficiency and the rate increases that are projected under the proposed treaty arrangements?

*Answer.* The estimated loss of \$350,000 in Canal revenues resulting from Sea-Land's decision is expected to have a negligible effect on the projected toll revenue deficiency under the proposed treaty arrangement.

2. Is there a substantial possibility that the net deficiency of toll revenues indicated on page 10 of your statement might increase or decrease markedly as more costs or savings are identified in connection with the proposed Commission? Which is more likely to be the case?

*Answer.* Since the November 30 hearings, preliminary results of our study to estimate costs and savings identified with treaty changes have become available. They indicate that for the first year under the treaty the increased costs would be slightly less than those estimated at the hearings, and that there appears to be a possibility of some additional savings over the succeeding years. Latest estimates of toll revenues are also slightly more optimistic, particularly in light of experience with North Slope oil movements to date. Both of these developments are favorable and should reduce the initial tolls increase required. As noted in the hearings, the estimates assume no payment of interest to the U.S. Treasury on the net direct investment of the United States and no payment to Panama under the treaty provision for a contingent \$10 million payment if revenues exceed expenditures.

*Question.* How precise are the present projections?

*Answer.* Tolls revenue deficiency estimates are based on projections of both costs and revenues. The cost projections are reasonably precise for functions to be retained by the Panama Canal Commission or transferred to the Department of Defense. The cost projections are less precise in regard to costs of services to be obtained from former Company functions transferred to Panama, but we consider them to be reasonable.

As for revenue projections, our original estimates were based on an in-house forecast made in February, 1977. Since then and in conjunction with the State Department, the Company commissioned a study by International Research Associates to provide a new revenue forecast and a current estimate of sensitivity to toll increases. Preliminary estimates indicate that the near term figures used in the November hearings will be exceeded by the new forecast. As a cautionary note, the new projections are not optimistic about long term growth.

3. On page 6 of your statement you reference the reduction in areas which are part of the proposed treaty arrangement. Please identify for the record of these hearings and in preparation for hearings by the Full Committee on Merchant Marine and Fisheries on property transfer:

*Question a.* the tracts of Canal Zone land that would be turned over to Panama upon the entry into force of the treaty arrangement, between the entry into force of the treaty arrangement and the year 2000, and all other land to be turned over by 2000 (perhaps the list of land and property in the Agreement in Implementation of Article III will be helpful); and

*Answer.* Attachment I describes the major tracts of land that would be turned over to the Republic of Panama within the requested time periods.

*Question b.* a list (in identical time categories) of major assets and structures to be turned over to Panama.

*Answer.* Attachment II lists the major assets and structures which would be transferred to the Republic of Panama within the requested time periods.

*Question 4.* In testimony before the Separation of Powers Subcommittee of the Senate Judiciary Committee on July 22, you cited certain facilities as being vital to the Canal's operation, and other facilities as only marginally import-

ant. If it can be assumed that the terms of use for facilities vital to the Canal's operation must have an effect on the costs of Canal operation, please compare the costs for these vital facilities under the present treaty arrangement with their projected costs under the proposed Canal Commission.

Answer. The facilities I alluded to, during my July 22, 1977 testimony before the Separation of Powers Subcommittee of the Senate Judiciary Committee, as being vital to the operation of the Canal are primarily those facilities used directly in support of our transit function. Under the terms and for the life of the treaties, the United States retains title and use of most of these facilities. Consequently, we do not anticipate any significant differences in Canal transit operating costs attributable to the use of these facilities under the new treaty arrangements.

#### CANAL ZONE LAND AND WATER AREAS THAT WOULD BE TURNED OVER TO PANAMA UNDER THE PROPOSED TREATIES

The land and water areas to be turned over to Panama are listed below in the following format:

- I. Areas To Be Turned Over Upon Entry Into Force:
  - A. Panama Canal Company/Canal Zone Government Land Areas
  - B. Military Land Areas
  - C. Water Areas
- II. Land Areas To Be Turned Over to Panama During the Life of the Treaty:
  - A. Panama Canal Company/Canal Zone Government Areas
  - B. Military Areas
- III. Provision for Additional Turnovers
- IV. Summary

##### I. AREAS TO BE TURNED OVER UPON ENTRY INTO FORCE

A. Panama Canal Company/Canal Zone Government land areas within the present Canal Zone that would be turned over to Panama upon entry into force of the proposed treaty arrangement approximate 82 sq. miles and are described below (reference Attachment No. 1, general map of the Lands and Waters of the Panama Canal Treaty):

NOTE.—The division between the Pacific Side of the Isthmus and Atlantic Side of Isthmus is approximately at Gamboa.

*Pacific Side of Isthmus East of the Canal.*—At the Pacific entrance to the Canal the Balboa Port area including the La Boca Tank Farm, the Balboa Industrial Area and a strip of land extending to Gaillard Highway on the east, the Canal on the west and Diablo on the north. Selected areas in Ancon (e.g., Shaler Plaza and Ancon Elementary School) and Balboa (e.g., Stevens Circle) townsites; Pedro Miguel and Paraiso townsites; and an area generally north of Fort Clayton, east of the railroad and south of Gamboa military licensed area extending to the Canal Zone boundary on the east.

*Pacific Side of Isthmus West of the Canal.*—At the Pacific entrance the coastal area including Palo Seco, Far Fan Hill/beach and Thatcher Highway; and an area north of Thatcher Highway west and south of the Military Area of Coordination (Empire Range) and extending west to present C. Z. boundary.

*Atlantic Side of Isthmus East of the Canal.*—The islands in Gatun Lake including Juan Gallegos, Zorra, and Advent; the area north of Fort Gulick military reservation including Old and New France Field extending to Manzanillo Bay on the west and the C. Z. boundary on the east and to just north of the France Field Airstrip and various selected areas in Coco Solo; the Cristobal Port area; Mt. Hope Tank Farm; Rainbow City townsite; Brazos Heights area; and the area between Margarita, Brazos Brooks, Fort Davis and the railroad right of way.

*Atlantic Side of Isthmus West of the Canal.*—A small land area south of Barro Colorado Island west of the Canal Operating Area and north and east of the military licensed area (area south of Barro Colorado Island) and various small islands in Gatun Lake.

B. Canal Zone lands designated as Military Reservations or licensed to the military that would be turned over to Panama upon entry into force of the proposed treaty arrangement approximate 122 sq. miles and are described below (reference Attachment No. 1, general map of the Lands and Waters of the Panama Canal Treaty).



*Pacific Side of Isthmus East of the Canal.*—At the Pacific entrance to the Canal the islands of Flamenco, Perico and Naos; a part of the Corozal Antenna Field; Ancon Hill; Albrook airfield area; Fort Clayton area directly north of Curundu extending to the northern boundary of Clayton Reservation; a part of the Fort Clayton Training area; Gamboa military licensed area adjacent to the south bank of the Chagres River; and various small military licensed areas.

*Pacific Side of Isthmus West of the Canal.*—At the Pacific entrance to the Canal the islands of Enad, Changame and Roca Penamarea; a portion of the Kobbe Military Reservation south of Thatcher Highway and east and north of the present C. Z. boundary and west of Howard Air Force Base/Fort Kobbe Defense Site; and a portion of the military licensed area (Balboa West Air to Ground Range) opposite Gamboa bounded on the north by the Canal Operating Area, west and north of the Military Area of Coordination (Empire Range) and extending west to the existing C. Z. boundary.

*Atlantic Side of Isthmus East of the Canal.*—The Gamboa military licensed area and Frijoles Bay licensed area west of the Chagres River and north of Cerro Pelado Ammunition Storage Dump extending to Gatun Lake between the railroad right of way and the C. Z. boundary; eastern part of Fort Gulick land area; the military licensed area just north of France Field Air Strip including the major part of Galeta Island; and the waterfront sections of Coco Solo.

*Atlantic Side of Isthmus West of the Canal.*—The military licensed areas (Gamboa Testing and Exercise Area and area south of Barro Colorado Island) west and south of the Canal Operating Area centered around Barro Colorado Island and north and east of the present C. Z. boundary; a portion of the military licensed area (Gatun Training) north of Escobal extending to the C. Z. boundary on the west and south of the Military Area of Coordination (Pina Jungle Training) and including a strip of land between S10 road and Gatun Lake; a tract of land including the western portion of Fort Sherman Military Reservation and a part of the military licensed area (Gatun Training) bounded on the north by the Atlantic coastline and on the east by S1 Road and on the south by the Military Area of Coordination (Pina Range) and on the west by the present C. Z. boundary; and Fort San Lorenzo area.

C. Canal Zone Water areas that would be turned over to Panama upon entry into force of the treaty arrangement approximating 168 sq. miles are described below (reference Attachment No. 1, general maps of the Lands and Waters of the Panama Canal Treaty).

All of Madden Lake; all of Gatun Lake except the Canal channel and the areas adjacent to both sides of the Canal; all of the Pacific anchorages and tide water areas except for the Pacific entrance channel; and Manzanillo Bay, Cristobal Port waters and the Atlantic Outer Anchorage. (Note: Under the Agreement in implementation of Article III of the Panama Canal Treaty the United States retains the rights to manage the lakes by controlling the water elevation, to maintain and protect the dams and to take other actions to ensure the water supply essential to the operation of the Canal. The United States also retains the rights to free and unimpeded access to and use of the anchorages including the right to maintain or improve as may be necessary or convenient.)

## II. LAND AREAS TO BE TURNED OVER TO PANAMA DURING THE LIFE OF THE TREATY

A. Canal Operating Areas which will be turned over to Panama during the life of the treaty.

Thirty calendar months following the entry into force of this agreement the land areas of: Balboa Police Station Complex; Balboa Magistrates Court.

At such time as the United States ceases to use such installations, but in no case longer than 30 months after implementation of this agreement unless the two government otherwise agree the land areas of: Balboa Commissary (723 and 726); Coco Solo Commissary (100 and 22).

Three years following the entry into force of this agreement the land areas of: Canal Zone Penitentiary; Ancon District Court; Cristobal Police Training Center.

Five years following the entry into force of this agreement the land areas of: Mount Hope Warehouse Area; Mount Hope Transportation Area.

At such time as subject areas are required by the Republic of Panama for expansion of the Port of Balboa the land areas of: Pier 20 area (including buildings 57 and 57-X; Scrap Yard Area (less building 42).

B. Military Areas of Coordination which will be turned over to Panama during the life of the treaty.

Three years from the entry into force of this agreement the land areas of: Curundu Antenna Farm; Curundu Heights Housing Area; Barracks Facilities at Fort Gulick for a Company of the Forces of the Republic of Panama as Agreed in the Joint Committee.

Five years from entry into force of this agreement the land areas of: Fort Gulick, except for Family Housing, Community Service Areas, and Ammunition Storage Facility; France Field.

Land areas that will be turned over to Panama when determined by the United States: Fort Clayton Training Area; Fort Amador; Fort Gulick Family Housing, Community Service Areas and Ammunition Storage Facility; Coco Solo Family Housing; Curundu Flats Housing Area comprising Contractors' Trailer Housing Area.

### III. PROVISION FOR ADDITIONAL TURNOVERS

During the life of the treaty no additional water areas have been identified for turnover to Panama. However, in the Agreement in Implementation of Article III of the Panama Canal Treaty there is a provision that every five years, or by agreement between the two Parties, the land and water areas made available to the United States will be reviewed for any agreed elimination or change in areas.

### IV. SUMMARY

At the year 2000, areas turned over to Panama upon entry into force of the treaty arrangement, plus the Canal Operating Area and the Defense Sites and Military Areas of Coordination, totaling approximately 372 sq. miles of land and 275 sq. miles of water (the sum of which is the present area of the Canal Zone), would have been turned over to Panama.

### MAJOR ASSETS AND STRUCTURES THAT WOULD BE TURNED OVER TO PANAMA UNDER THE PROPOSED TREATIES

#### *On entry of treaties into force*

Inner harbor improvements, Cristobal and Balboa.

Dry dock No. 1, Balboa, pumphouse and supporting shops and equipment.

Thatcher Ferry Bridge.

Marine bunkering facilities, including La Boca and Mount Hope tank farms, pipelines, and pumping facilities.

Cargo handling facilities, including docks, piers, sheds, and handling equipment.

Employee quarters, all townsites.<sup>1</sup>

Balboa Service Center and theater.

Railroad main line and spur tracks.

Railroad stations, platforms, and freight houses.

Railroad rolling stock.

Atlantic and Pacific terminal buildings.

Balboa and Gamboa post offices.

Latin American schools.

Ancon Elementary School.

Roads, streets and sidewalks in areas to be turned over to Panama.

Sewers and fire hydrants in areas to be turned over to Panama.

Townsite improvements in areas to be turned over to Panama.

Street lighting systems in areas to be turned over to Panama.

Recreational facilities in areas to be turned over to Panama.

Palo Seco Hospital.

Civil Affairs Building.

#### *During early life of the treaties*

Merchandise warehouses.

Balboa and Coco Solo retail stores.

<sup>1</sup> This includes Panama Canal houses located in the townsites of Pedro Miguel, Paraiso, and Rainbow City. It also includes Panama Canal houses, located in other townsites, the use of which will be granted by Panama to the Commission to house U.S. citizen employees. These houses will be relinquished to Panama over the life of the treaties in accordance with a prescribed schedule.



Mount Hope motor transportation facilities.  
 Penitentiary.  
 Balboa police station.  
 Balboa Magistrates' Court.  
 District Court House.

*At end of treaties period*

Panama Canal channel with Atlantic and Pacific approaches.  
 Breakwaters.  
 Dams and spillways.  
 Locks excavations, structures, and towing locomotives.  
 Dredging facilities.  
 Aids to navigation.  
 Marine traffic control facilities.  
 Navigation service facilities, including docks, towboats, and launches.  
 Vessel repair facilities.  
 Meteorological and hydrographic facilities.  
 Engineering and maintenance facilities.  
 Laundry facilities.<sup>2</sup>  
 Motor transportation facilities.  
 Power system.  
 Communication system.  
 Water system.  
 Central air conditioning system.  
 Printing and binding facilities.  
 Grounds maintenance equipment.  
 Storehouses.  
 Administration Building.  
 Miscellaneous Company and Government buildings.  
 Fire stations.  
 U.S. schools.<sup>2</sup>  
 Roads, streets, sidewalks.  
 Sewers and fire hydrants.  
 Street lighting systems.  
 Gorgas and Coco Solo Hospitals.<sup>2</sup>  
 Mental Health Center.<sup>2</sup>

QUESTIONS FOR THE TREASURY DEPARTMENT

*Question 1.* A major premise of your statement is that ratification of the proposed treaty arrangement will strengthen the investment climate in Panama, and that execution of the economic cooperation package will enhance the U.S. economic position as well as Panama's.

What restrictions are there on U.S. investment in Panama?

What are the basic rules for foreign investment and what restrictions are there on U.S. investment in Panama?

*Answer.* The Government of Panama welcomes direct foreign investment and imposes few restrictions on foreign investors. U.S. currency is legal tender in Panama, and there are no foreign exchange restrictions (except for transactions with Rhodesia). Panama's industrial incentives law of 1970 provides privileges and tax concessions for periods of up to 15 years, depending upon location and whether the company produces entirely for local consumption or export. Similar legislation provides incentives to investors in new hotels and other tourism projects. Panama does protect new industries by import duties or quotas on competing imports, but not uniformly. Panama imposes few import quotas, and import duties are generally moderate. To ensure domestic supply, the Government occasionally restricts exports on certain basic products.

No limitations are imposed upon the extent of ownership by foreigners except for retail trade, radio stations, and certain public utilities. Panama's labor code permits only 10 percent of the ordinary workers and 15 percent of specialized technical workers in a business to be foreigners. The Government sets minimum wage rates for all workers on a graduated scale, with the highest rates (from 50 to 86 cents per hour, depending on the type of business) applicable in the major

<sup>2</sup> These properties will be transferred to other U.S. Government agencies during the life of the treaties and in turn will be transferred by them to the Republic of Panama upon termination of the treaties.

cities. Bidding for government procurement is open to foreign and domestic firms on an equal basis, provided the former has a local representative.

*Question 2.* If it is a matter of public record, which U.S. investments in Panama are guaranteed by the Overseas Private Investment Corporation?

What are the terms of those guarantees, and would they relate at all to the projected \$20 million guarantee for borrowing by the Panamanian development bank?

Which U.S. investments in Panama are guaranteed by OPIC? What are the terms of those guarantees? How would these terms relate to the projected \$20 million guarantee for borrowing by the Panamanian development bank (CAOF) million guarantee for borrowing by the Panamanian development bank (COFINA)?

Answer. OPIC has issued no loan guarantees in Panama, but has written political risk insurance in Panama and made one loan there.

#### QUESTION FOR MARITIME ADMINISTRATION

*Question.* On page 3 of your statement you indicate some shipping companies would 'undoubtedly face economic hardship or even total business failure' as a consequence of Canal closure.

*Question.* Is it correct that major toll increases (25 to 40 percent) would have less of an impact?

*Question.* On what trade routes are the companies that would face hardship or failure if the Canal were closed or tolls raised precipitously? Are these U.S. companies?

U.S. DEPARTMENT OF COMMERCE,  
THE ASSISTANT SECRETARY FOR MARITIME AFFAIRS,  
*Washington, D.C.*

#### COMMITTEE ON MERCHANT MARINE AND FISHERIES *Washington, D.C.*

GENTLEMEN: I am pleased to reply to Mr. Metcalfe's questions which were attached to your December 14 memorandum to Mr. Casey.

It is our view, as you indicated in the preface to your first question, that Panama Canal toll increases in the range of 25 to 40 percent would have much less of an impact on U.S. shipping than a Canal closure. We have argued that the suggested toll increase might result in a small initial loss of carriage to U.S.-flag operators, but we think this loss would probably be regained within a year or two as world trade volume continues to rise. However, we have also pointed out that much of the U.S.-flag loss could be concentrated among those carriers who serve small markets in which added transportation costs cannot be passed on to consumers. Certain U.S.-flag operators on Trade Routes 2 and 31 (U.S. Atlantic and Gulf to the West Coast of South America) might be among those who feel the greatest impact.

In reference to your second question, Canal closure, or extremely high toll increases, would have a much more sweeping effect than toll increases of 25 to 40 percent because of the diversion of a considerable amount of cargo to minibridge systems. For example, U.S. East Coast or Gulf shipments to the Far East (Trade Routes 12 and 22), or to the West Coast of South America (Trade Routes 2 and 31) would tend to go overland to the West Coast for transfer to ships. West Coast shipments to the North or East Coast of South America (Trade Routes 23 and 24), or to Europe or Africa (Trade Route 26), would tend to be shipped overland to the East or Gulf Coasts before going by sea. Present waterborne domestic shipments between the East or Gulf Coasts and the West Coast would rely on land transport completely for many commodities and at least partially for bulk commodities.

Accordingly, it seems apparent that Canal closure would force immediate widespread changes in U.S. shipping operations which would lead to a redefinition of major U.S. trade routes in terms of their land transport component. We think that some U.S. companies on these routes probably would not be financially able to make the significant adjustments required in their operations and that these companies could go out of business.

In addition, although the Maritime Administration is, of course, primarily concerned with U.S.-flag operators, we think it may be predicted that other flag operators—for example, those that service the Central and South American countries that are so dependent on the Canal in their trade—would also be hurt by a Canal closure.



I hope that this information is helpful. Please contact me if we can be of any further assistance.

Sincerely,

SAMUEL B. NEMIROW  
(For ROBERT J. BLACKWELL,  
Assistant Secretary for Maritime Affairs).

#### QUESTIONS FOR ELY M. BRANDES

*Question 1.* You stated that your services were contracted by the Department of State during the recent Panama Canal treaty negotiations. Did you review the canal revenue projections prepared by the U.S. negotiating team?

Is it your opinion that the data and projections prepared by the U.S. negotiating team were based on the best information available at the time?

*Question 2.* You indicate on pages 3 and 4 of your testimony that in most instances the individual buyer or consumer is the ultimate payer of Canal tolls. It has been said that the elasticity of demand and competition for many of the products of the developing countries (including many Latin American countries) will cause the producers to absorb the cost of tolls increases. To what extent is this the case?

*Question 3.* For whom was the 1975 tolls sensitivity study of International Research Associates done?

What was the purpose of the study?

Please insert into the record any appropriate excerpts from the study.

#### ANSWERS FOR MR. METCALFE

Answer 1. Yes, I did review the Panama Canal traffic and revenue projections used by the U.S. negotiating team, as well as sensitivity estimates used in projecting additional toll revenue that might be available through toll increases.

It was my opinion that the estimates used were the best available; however, I also pointed out that these best available estimates were three years old and this impaired the quality of the estimates.

Answer 2. The wholesale prices for certain tropical products such as bananas, coffee, and cocoa are usually set with respect to the principal market centers, rather than with respect to production centers. For all three of the above products, New York is an important market center; and as a result, producers who are geographically closer to New York have a built-in cost advantage over producers who are farther away. As a result, banana producers in Mexico, for instance, have a cost advantage over banana producers in Ecuador. And this cost advantage would be further increased by a toll increase at the Panama Canal.

This situation is caused not by demand elasticity but by the presence of many, relatively small producers in relation to total supply.

Answer. (a) The 1975 toll sensitivity study was conducted for the Panama Canal Company.

(b) The purpose of the study was to present estimates of the effect of toll increases ranging from 15 to 150% on future traffic volume. A second purpose was to estimate the maximum amount of toll revenue that can be produced at the Panama Canal.

(c) In summary, the study found that the maximum toll rate increase that could be imposed was in the range of between 75 and 100%, and that such a toll rate increase would raise revenues by about 50% over the level projected without an increase.

ARTHUR ANDERSEN & Co.,  
Chicago, Ill., December 22, 1977.

Subject: Questions for the Record.  
SUBCOMMITTEE ON PANAMA CANAL,  
Washington, D.C.

GENTLEMEN: Pursuant to your request of December 14, set forth below are the questions I received from the members of the Subcommittee, together with my response thereto. If you wish me to elaborate further on any of these questions or if I can be of further assistance in any other way, please let me know.

*Question No. 1.* Several of those factors which you reference in your statement with respect to the viability of the Panama Canal Commission (e.g., concepts of frozen technology and economic maturity of the Canal) convey the implication that the Canal will be more financially difficult to operate in the future regardless of the applicable treaty arrangement.

Do you expect that the finances of the Canal would become a growing problem under the present treaty arrangement? If so, to what extent will they be a problem?

What are the key differences which would distinguish financial problems under the present and proposed arrangements?

Response to Question No. 1. The Subcommittee may recall that prior to the Panama Canal Company's last toll increase, open hearings were held concerning the financial problems of the Panama Canal Company. At that time both the Subcommittee and its parent, Committee on Merchant Marine and Fisheries, expressed deep concern about the deteriorating financial position of the Panama Canal organization. In a letter to the Panama Canal Company, Chairpersons Metcalfe and Sullivan indicated that "If the value of the Panama Canal is diminished in the views of its users, we may find that the successful increases in Canal fees of the last three years are counterproductive and possibly portend a situation which will ultimately terminate the role of the Canal as a major thoroughfare of international oceanic commerce. In short, it seems clear that this issue goes to the very root of the viable existence of the Panama Canal itself." Others expressed similar concerns regarding the growing financial problems of the Panama Canal Company.

Although sharing to some degree these concerns, I was optimistic that the Panama Canal Company was only experiencing a temporary financial depression. This has turned out to be the case and a combination of positive factors including strong budgetary controls imposed by Governor Parfitt which decreased costs, additional revenue from a toll increase, and the start of the flow of Alaskan oil have turned around the financial fortune of the Company. However, there is reason to be concerned about the long-term financial viability even under present treaty arrangements as I expressed in my testimony.

The key difference which would distinguish the financial problems of the Canal enterprise under the present arrangement from those under the proposed arrangements is the additional burden imposed on the Canal's revenue stream under the latter. These burdens include divestiture of certain profitable activities and the imposition of additional costs including the obligations to the Republic of Panama, certain of which are to be inflation adjusted, and other additional costs such as training and personnel rotation.

*Question No. 2.* If "the ability to increase tolls and inflation are not interdependent," and if "(I)t is no means clear that future tolls of the Panama Canal can be increased at the same rate as future inflation," upon what basis should any payments to Panama on Panama Canal net tonnage be made?

Would not payments as a percentage of toll rates or other mechanisms present the same problem as the inflationary index provision of Article XIII?

Response to Question No. 2. From a financial management prospective it would be economically inadvisable to incur any costs which could not be recovered from revenues. Thus it appears to me that the upper limit of the obligations incurred by any financially viable organization should be based upon an ability to generate resources sufficient to discharge those financial obligations. If obligations are incurred which pierce that upper limit, then additional sources of funds must be derived in order to avoid bankruptcy. The mechanism selected to compute the compensation payments to the Republic of Panama is far less significant than the ultimate magnitude of the payment to be made.

*Question No. 3.* Testimony before the Subcommittee indicates that the Treasury Department raised the idea of the contingent \$10 million payment as an incentive for Panama to keep Canal operating costs down. Aside from the problems which stem from the language of the provision containing the contingent payment, do you believe the concept of the payment as an incentive is sound?

Does the soundness depend upon how the payment is treated with respect to the tolls formula?

Response to Question No. 3. I do believe that providing an incentive to hold costs to minimum levels is a sound business practice. The soundness of the indicated incentive does depend at least in part on how the incentive is treated with respect to the tolls formula. Also, as I indicated in my testimony, there should be a sound accounting for all Canal operating costs in accordance with generally accepted accounting principles and such costs should be stated consistently for purposes of determining both toll revenue requirements and the availability of financial surplus for payments to the Republic of Panama as well as for purposes of external financial reporting.

Very truly yours,

LEONARD J. KUJAWA.



## QUESTIONS FOR PHILIP L. STEERS, JR.

*Question 1.* One of the major underpinnings of your outlook for the financial viability of the Panama Canal Commission was the projection of a more moderate growth of Canal traffic in years ahead. Other than from Mr. Kujawa's statement, what analyses project a more moderate growth of Canal traffic in years ahead?

*Question 2.* If the proposed treaties were to be ratified and the Panama Canal Commission were to adopt the principle of depreciation on a replacement cost basis, would this not cause the operating expenses of the Commission to rise, and tolls concomitantly, thus vitiating any economy attractiveness the Canal may have?

Responses to these questions were not available at the time the hearing record was being printed.

HARVARD LAW SCHOOL.

Cambridge, Mass., December 22, 1977.

Hon. RALPH H. METCALFE,

*Chairman, Panama Canal Subcommittee, Committee on Merchant Marine and Fisheries, Washington, D.C.*

DEAR CONGRESSMAN METCALFE: I enclose in accordance with the Subcommittee's memorandum of 14th December, the answers to the supplementary questions that were put to me in connection with the recent hearings on the new Panama Canal Treaties.

May I take this occasion to thank you again for the very kind reception accorded to me by you and your colleagues as well as by members of the Subcommittee staff. I particularly appreciated your thoughtfulness in excusing me so that I might return to Cambridge in time to teach.

Yours sincerely,

R. R. BAXTER.

Enclosure.

REPLIES OF R. R. BAXTER TO THE SUPPLEMENTARY QUESTIONS PUT TO HIM

*Question 1.* On page 6 of your testimony you justify canal user payments under the proposed treaty arrangement to the territorial sovereign, Panama. What precedents can you cite either for payments made to the territorial sovereign of an interoceanic canal or profits made by the sovereign in operating an interoceanic canal?

Do payments to the sovereign, as mandated by the proposed treaty arrangement, equate with a profit?

Answer. When the Suez Canal was still under the administration of the *Compagnie Universelle du Canal Maritime de Suez* (that is, prior to the nationalization of the Canal in 1956), the Company was obliged to pay an annuity of 7 percent of its gross profits, with a minimum of £E 350,000, to the Egyptian Government. In addition, under the terms of its concessions, the Company was obliged to provide certain benefits to the Egyptian Government, such as the construction of a fishing port undertaken by the Company pursuant to an agreement of 1949. The Company was subject to certain Egyptian taxes, such as the tax on undistributed profits, and was required to collect the Egyptian tax on sum distributed by the Company to its shareholders.

Shares in the old *Compagnie Universelle du Canal Maritime de Suez* were regarded as gilt-edged investments because of the handsome revenues of the Company. It was the desire for these revenues that was one of the primary motivations for the nationalization of the Canal in 1956. The reopening of the Canal in 1975, after it had been shut down for eight years as the result of the 1967 War, was also prompted by Egypt's need for income from the Canal. The level of tolls upon the reopening of the Canal was almost double what it was in 1967.

The answer to the question posed in the second paragraph depends very largely on how costs are allocated and what accounting principles are followed. If the Panamanian Government has certain overhead expenses in connection with the Canal or is subjected to certain burdens because of the presence of the Canal, the payments under the new Treaty might be used to defray those expenses. If the payments do not offset any costs to the Government of Panama, then they might be called "profit."

*Question 2.* You state that the right of free use of the Panama Canal has been established by customary international law. Are reasonable levels of tolls and efficient service established in customary law apart from the treaties?

Does it matter if these are established customarily, since the proposed Neutrality Treaty is more explicit with respect to reasonableness and efficient (ancillary) service?

Answer. Reasonable levels of tolls and efficient service cannot be said to be, in and of themselves, established rules of international law. Rather, they are components of the right of "free and open" or "secure and open" transit. The operator of a canal cannot be allowed to do indirectly what it is precluded from doing directly—to deny transit to shipping relying on the canal. A canal could be as effectively blocked by putting tolls at a prohibitively high level or by denying the technical services necessary to passage by an outright prohibition of transit. For that reason, tolls must be set at a reasonable level and services provided in order to carry out the duty of maintaining "secure and open" transit.

As to the question in the second paragraph, the right granted by the treaty would naturally be relied upon preference to the less precise obligations imposed by customary international law. The duties imposed under customary international law would be of consequence only if there were to be an attempt by the parties to the treaty to terminate its operation.

*Question 3.* Mr. Maechling states on page 9 of his testimony that "No international canal has so far remained 'neutral' when the littoral state itself was a belligerent." Do you believe this statement ought to be qualified?

Answer. I agree with Mr. Maechling's statement that "No international canal has so far remained 'neutral' when the littoral state itself was a belligerent," at least as to the twentieth century. The "neutrality" of a canal applies to a situation in which neither the territorial sovereign nor the operator of the canal is engaged in war or some other form of armed conflict. Other belligerents are required to respect the neutrality of the canal when the territorial sovereign and the operator are not at war or engaged in some other form of armed conflict.

The recent practice with respect to the Kiel, Suez, and Panama Canals has been for the territorial sovereign to exercise belligerent rights with respect to neutral and enemy merchant vessels when the territorial sovereign has been engaged in war or conflict. According to the information available to me, no warship of an enemy of the territorial sovereign has ever laid claim to peaceful and unmolested transit through an interoceanic canal.

This question is more fully treated in my book "The Law of International Waterways," 187-244 (1964).

#### RESPONSES TO QUESTIONS FOR CHARLES MAECHLING, JR.

*Question 1.* The Neutrality Treaty is a bilateral agreement between the United States and Panama. Will this then have the effect of keeping the U.S. and Panama out of international courts of law if user countries sue against the Canal operator?

Answer. It would have a deterrent effect. Any third country user would have a right to sue the Canal proprietor (i.e. the United States of Panama, depending on whether before 2000 A.D. or after) even though it was not a signatory of the treaty. But since the third country would not have a specific treaty instrument to sue under, it would have to proceed on the basis of user rights to an international waterway, or some similar theory, rather as a treaty party. This would leave the door open for jurisdictional or procedural defenses that would not be available from one party to another.

The question points up the weakness of a bilateral treaty for an international waterway.

*Question 2.* On page 6 of your testimony you state that the proposed treaty arrangement does not "prevent Panama from imposing a totally discriminatory rate structure—based, for example, on flag of vessel or class of cargo—so long as such rates were levied on all traffic equally \* \* \*

Answer. A discriminatory rate structure slanted in favor of particular classes of cargo would clearly be permissible under Article II. A rate structure slanted in favor of certain nationalities or flags would be more difficult to justify, but not if couched in a way that covered the class without seeming to discriminate against particular flags.

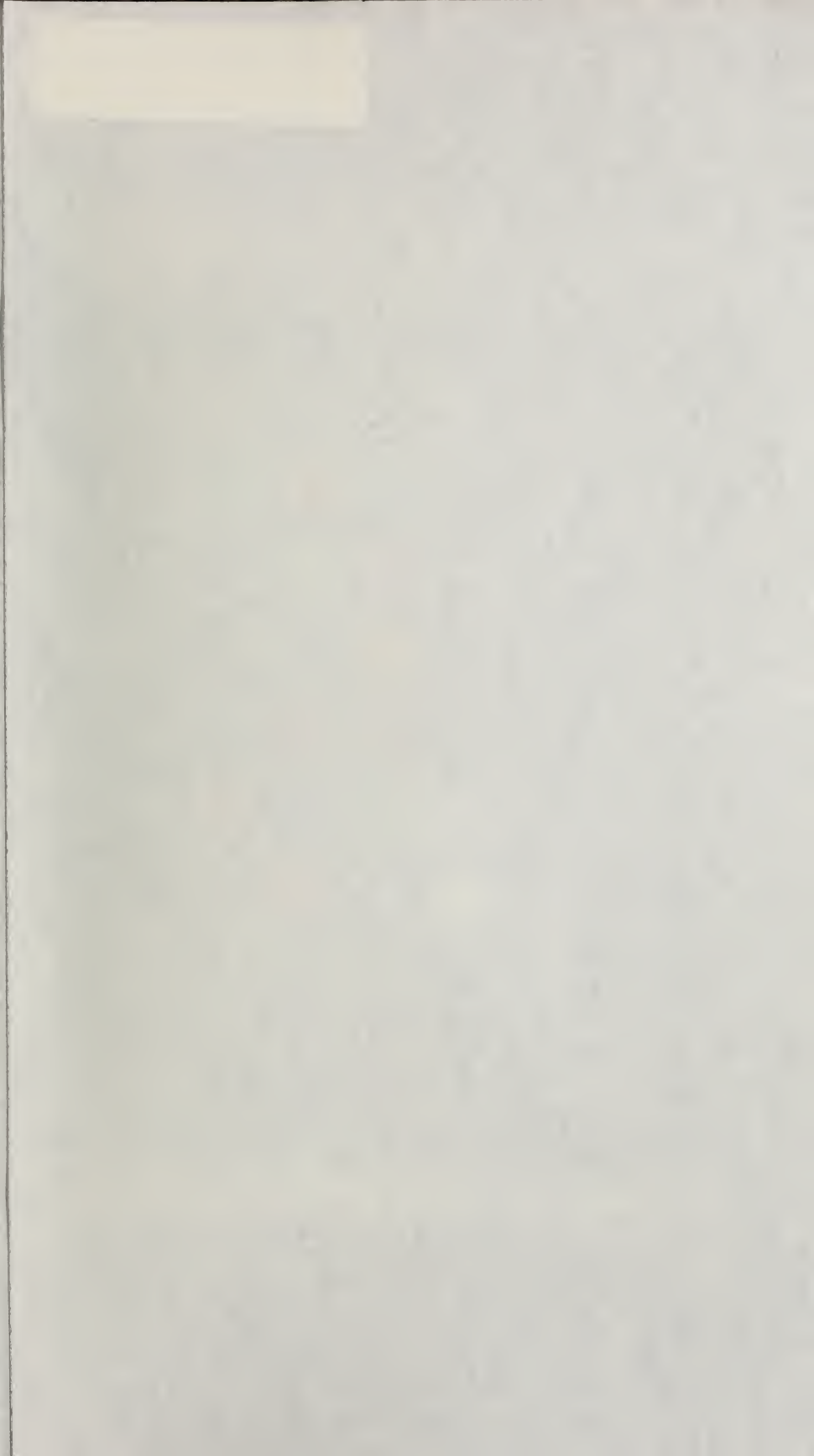
*Question 3.* You referenced Egypt's Declaration of June 1957 as an example of the type of guarantee that Panama should provide. Can Egypt withdraw that declaration unilaterally without being subject to international legal challenge or consequences from Canal users? Could Panama issue a declaration and then withdraw it without consequences?



Answer. In theory Egypt could withdraw its Declaration of June 1957, but since it was deposited with the U.N., and other nations have acted in reliance on it, a strong case could be made that by now the principles of the Declaration, at least, have become solidified in international law. A withdrawal of the Declaration that threatened the Suez Canal's international status and "dedication" to the world community would obviously result in vigorous international challenge.

Panama's issuance of a similar declaration would vastly strengthen the Canal's international status and rights of user's. It could of course be withdrawn, but with similar consequences as regards the Suez Declaration.

[COMMITTEE NOTE.—See part 2 for additional appendices.]





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